

**DIVIDEND POLICY AND STOCK MARKET REACTION TO DIVIDEND
ANNOUNCEMENTS IN NIGERIA**

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ABSTRACT

The impact of dividend announcements on firm value represents one of the longest standing puzzles in the literature of modern finance. Based on either a behavioural or empirical approach, studies have provided rationales to address the issue of why companies pay dividends and whether the market response to the announcements can be predicted. However, these studies have failed to resolve the dividend puzzle, as no single convincing explanation about the observed dividend behaviour of firms has emerged. Moreover, most of these studies have been conducted in countries with developed capital markets; there is very little attention to corporate dividend policy research that addresses issues related to the development of emerging stock markets of sub-Saharan Africa, such as Nigeria. This thesis seeks to fill this gap in the literature by investigating the factors that drive dividend decision and the impact of dividend announcements on the share prices of listed companies in Nigeria. The Nigerian equity market is characterised by a distinctive tax system where personal income from dividends is taxable, while capital gains are exempt from taxation. This unique taxation structure presents an additional motivation for research to ascertain why Nigerian listed companies continue to pay dividends, despite the tax consequences associated with such a disbursement.

For the purpose of the research in this thesis, a mixed-method research design, consisting of both the quantitative and qualitative approaches was employed. The perspectives of Nigerian managers on the factors that drive dividend decision and the relevance of dividend policy to firm value was investigated using a postal questionnaire survey. This was followed by an empirical investigation of the stock market reaction to cash dividend announcements in Nigeria employing a market-based standard event study methodology. Finally, interviews were conducted with 21 financial managers of Nigerian listed companies to ascertain their views on various dividend policy issues as a means of validating the findings from the questionnaire survey and the event study analysis.

The findings from the questionnaire survey and the interviews indicate that Nigerian listed companies' exhibit dividend conservatism and typically focus on the level of current earnings, the stability of earnings and liquidity considerations such as the availability of cash when determining their current dividend levels. Nigerian managers believe that dividend policy affect firm valuation, and also express strong support for the signalling explanation for paying dividends, but not for the bird-in-the-hand, tax-preference, or agency cost explanations. However, majority of Nigerian listed companies do not have target payout ratios; instead, companies target the dividend per share when determining their disbursement level. Nevertheless, views regarding some of these issues differ between financial and non-financial firms. The results of the event study analysis show that the Nigerian stock market reacts significantly to cash dividend announcements, implying that dividends do convey price-sensitive information to the market. However, there is evidence of both lagging and sluggish response to cash dividend announcements, suggesting that the Nigerian stock market is not semi-strong efficient.

The thesis makes a novel contribution to the growing body of corporate finance literature by providing additional evidence on the impact of dividend announcements on share prices from the context of an emerging market. As well as being timely in view of the dearth of empirical studies on stock market reaction to cash dividend announcements in Nigeria, the research is also important because it takes account of a novel feature of the Nigerian tax environment, where personal income from dividends is taxable while capital gains are exempt from taxation during the period of this study. In addition, the study is also unique because it examined the views of managers from both the financial and non-financial firms, thereby contributing to the literature on industry-related dividend effect. The focus of the investigation is also novel in that the study is the first comprehensive investigation of the perceptions of Nigerian corporate managers on dividend policy.

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No pain, no palm; no thorns, no throne; no gall, no glory; no cross, no crown.
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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Dividend policy has been the subject of extensive theoretical and empirical research in corporate finance. Dividend policy is defined as the payout policy that management follows in determining the size and pattern of cash distributions to shareholders over time (Lease *et al.*, 2000). A corporation that plans to distribute earnings to its shareholders may do so either by paying cash dividends or by share repurchases (Brennan and Thakor, 1990; Brealey *et al.*, 2008). The dividend paid in cash has two vital ramifications for the investors: (i) it meets the liquidity demand of the investor, and (ii) it has vital information content as to its announcement. On the contrary, distribution of earnings as dividends may starve the firm of funds required for growth and expansion, and this may cause the firm to seek for additional external capital which subjects the firm to the scrutiny and disciplining effects of capital market regulators.

The focal point of financial management is the goal of shareholder wealth maximization. To achieve this corporate goal, managers make various corporate financial decisions, such as those pertaining to investment, financing, and dividend policy. Dividend policy is considered one of the most vital issues for management decisions because evidence from the literature suggests that it is an important source for companies to communicate with market participants (Lonie *et al.*, 1996; Al-Yahyaee *et al.*, 2011; Gupta *et al.*, 2012). The main objective of dividend policy is to maximize shareholders' wealth by maximizing their purchasing power (Arnold, 2008). The realization of the corporate goal of shareholder wealth maximization depends to a large extent on the decision to retain and re-invest or distribute after-tax earnings in the form of cash or stock dividends (Oyejide, 1976; Ariyo, 1983; Lease *et al.*, 2000; Reynolds, 2004). Much of the academic debate surrounding dividend policy deals with the issue of why firms pay dividends and whether the selection of a particular dividend policy can influence the value of a firm.

Numerous studies have provided rationales to address the issue of why firms pay dividends and the impact of such a disbursement on the value of a firm, but a pervasive, time-invariant solution to the dividend puzzle appears to be lacking (McCluskey *et al.*, 2007).

Moreover, most of these studies have been conducted in countries with developed capital markets such as the US (Lintner, 1956; Petit, 1972; Baker *et al.*, 1985; Brav *et al.*, 2005), UK (Lonie *et al.*, 1996; Abeyratna and Power, 2002; Dhanani, 2005), Canada (Baker *et al.*, 2008), Australia (Easton, 1991) and in Ireland (McCluskey *et al.*, 2006; McCluskey *et al.*, 2007; Kester and Robbins, 2011). The literature has paid very little academic attention to corporate dividend policy research that addresses issues related to the development of emerging stock markets of sub-Saharan Africa, such as Nigeria. This shortfall represents a significant gap in the literature of which the current thesis seeks to fill. Moreover, emerging issues in the dividend research suggests that corporate dividend payout policies vary across countries, and between developed and developing markets. Specifically, firms in emerging markets differ from their counterparts in developed markets in many institutional characteristics such as size, information efficiency, corporate governance institutions, ownership structure, and taxation on dividends and capital gains, and dividend policy is expected to obey different dynamics (Glen *et al.*, 1995; Kumar and Tsetsekos, 1999; La Porta *et al.*, 2000; Ramcharran, 2001; Aivazian *et al.*, 2003). This factor provides an additional motivation for the decision to examine the dividend puzzle in the context of an emerging market as the findings will help enlighten the debate on comparative research on this issue.

The purpose of this study is to investigate whether cash dividend announcements create value for companies listed on the Nigerian Stock Exchange (NSE). Specifically, the study examines the market reaction to cash dividend announcements in Nigeria to determine whether or not dividends convey price-sensitive information to investors. It also investigates the perspectives of corporate managers of Nigerian financial and non-financial firms on the factors that drive dividend decision and the relevance of dividend policy to firm value. The dividend literature suggests that industry classification affects dividend policy (Lintner, 1956; Baker *et al.*, 1985; Barclays *et al.*, 1995; Baker *et al.*, 2001, Baker *et al.*, 2008). To examine this industry-related dividend effect, the current study partitions firms into two broad groups: financial and non-financial firms because of the wide dispersion of the responding Nigerian firms among various industry classifications.¹ Several important economic and institutional characteristics make Nigeria an interesting environment to

¹ The relative low response rate among several industry groups may not allow for reliable comparison of dividend policy among several industry groups.

examine the dividend policy and stock market reaction to dividend announcements. Strictly speaking, the Nigerian stock market represents an interesting case for this study because it has at least four interesting characteristics that make its study relevant in terms of policy recommendations for this country and others in the sub-Saharan African region.

First, the unique tax system in Nigeria during the period of time covered by this study allows the researcher to examine the tax-based signalling hypothesis associated with Black's (1976) dividend puzzle. The author questions why firms pay cash dividends that are usually taxed at a higher rate than capital gains. An answer to this question is provided by the tax-based signalling models, which suggests that the higher tax on dividends relative to capital gains make dividends informative about the company's future earnings (Bhattacharya, 1979; John and Williams, 1985). In Nigeria, personal income from dividends is taxable while capital gains are tax exempt.² This feature suggests that dividends may be used as a costly-to-replicate signal in Nigeria. On the other hand, since dividends are tax-disadvantaged relative to capital gains, the tax system in Nigeria is skewed in favour of the distribution of earnings in the form of stock dividends than cash disbursements. 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 untypical tax system presents an interesting environment for research to examine the actual motivation for paying dividends, despite the tax consequences associated with such a disbursement.

Second, the ownership structure of Nigerian firms is highly concentrated with inactive trading of shares (Adenikinju *et al.*, 2003). In Nigeria, companies are owned by a small group of investors who have controlling interests. Concentrated ownership increase the information asymmetry between corporate insiders and outside investors as well as the agency conflicts between the two parties. This argument suggests that dividend payments can be used both as an information-signal and as a disciplinary mechanism in Nigeria. On a related note, the Nigerian corporate context is characterised by low shareholder protection, lack of access to information by all shareholders and poor corporate governance (Abor and Fiador, 2013). In addition, there is low level of transparency of reported accounting

² Any dividend distribution made by a Nigerian company is liable to a withholding tax at source of 10 per cent.

information and corporate disclosure requirements are not well-observed. Since investors have little sources of information on Nigerian firms, dividend announcements can be an important source of information in pricing shares in Nigeria. Tsu and Tway (2007) noted that high ownership concentration resulted from poor legal protection, and this makes dividends valuable in solving agency and information problems.

Third, the dividend distribution in Nigeria exhibits remarkable differences from those of the US and other developed markets. For instance, unlike the US and the UK where dividends are paid on quarterly and semi-annual basis respectively, Nigerian listed companies typically distribute dividends annually, usually at the companies' financial year end.³ This factor may have an important influence on the ex-dividend price behaviour because declaring dividends annually may deprive dividend announcements of a significant element of surprise. In addition, Nigerian listed companies change their dividends frequently, which might affect the information content of dividend announcements. The literature suggests that variability in cash dividends diminishes the information content of dividends (Chen *et al.*, 2002). These features suggest that cash dividend announcements may send a weak signal to the Nigerian market. Moreover, some companies announce cash dividends and stock dividends (known as bonus issue in Nigeria) concurrently during the financial year end (Campbell and Ohuocha, 2011). The joint announcements of these corporate events make it difficult for investors to interpret the complex messages often contained in mixed signals and to unravel the relevant information conveyed by individual decision. While few studies have examined the stock market reaction to dividend announcements in Nigeria (Olowe, 1998; Adelegan, 2009; Campbell and Ohuocha, 2011), there is no prior study that has examined the stock market reaction to cash dividend announcements, taking into account the effect of other announcements that occurred before the cash dividend ex-dates. The current study seeks to address this pitfall; it investigates the stock market reaction to annual cash dividend announcements occurring with no interim or stock dividends.

Finally, 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

³ Yet, the timing of dividend announcements are not known with complete certainty because the majority of listed companies choose their announcement dates outside the NSE announcement window.

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 (CBN, 2000). Moreover, with the introduction of the Electronic Contributor System, the Nigerian stock market is able to beam stock market operations to the outside world via the Reuters International Information Network. These innovations are expected to have an impact on the dividend setting process in Nigeria. This is because technological development and increased integration of the Nigerian capital market may have increased the availability of financial information which has important implications for the efficiency of the stock market. Overall, the aforementioned institutional features make Nigeria an ideal environment in which to examine the impact of cash dividend distributions on firm value.

The theoretical framework of the impact of dividend distributions on firm value revolves around two schools of thought, which have divergent views. The first school of thought is the 'Dividend Relevance' theory, which suggests that dividend policy has a positive impact on shareholders wealth. Prior to the publication of the Miller-Modigliani dividend irrelevance hypothesis in 1961, the general consensus among academics is that a properly managed dividend policy is critical to the value of a firm. The proponents of the dividend relevance theory claimed that the dividend payout ratio has a significant effect on the equilibrium market value of a firm's stock and that maintenance of a ratio which maximizes stock price is the proper objective of dividend policy (Graham and Dodd, 1934; Gordon, 1959, Fisher, 1961). For example, Graham and Dodd (1934) argued that the only reason firms exist is to pay dividends, while Gordon (1959) maintained that the more generous the dividend policy of a company, the higher the share the price of that company. The supposition that high dividend payout ratios have a positive association with future earnings growth is supported by both conventional wisdom and recent academic studies (Arnott and Asness, 2003; Ap Gwilym *et al.*, 2006; Zhou and Ruland, 2006; Huang *et al.*, 2009).

The second school of thought is the "Dividend Irrelevance" hypothesis advanced by Miller and Modigliani (1961) and supported by Black and Scholes (1974), Miller and Scholes (1982), and Bernstein (1996). In a seminal paper, Miller and Modigliani (1961) demonstrated that firm value is independent of its dividend policy if a production-investment decision is made. They argued that investors can undo management's decision on dividend policy by either

reinvesting dividends or selling off stock. In other words, investors are indifferent as to whether they receive the firm's earnings in the form of dividends or capital gains and would be unconcerned with the erratic dividends that would result from adherence to residual dividend policy. The dividend irrelevance hypothesis is based upon an idealistic assumption of a perfect capital market with rational investors. In a perfect capital market, (i) information is costless and available to everyone equally, (ii) no distorting taxes exist, (iii) floatation and transaction costs are non-existent, (iv) no contracting or agency costs exist, and (v) investors are not systematically irrational.

In the real world, the capital market is neither perfect nor complete. Consequently, the dividend irrelevance hypothesis has been criticized because of its assumption of a perfect capital market with rational investors as opposed to actual securities market which suffer from several imperfections. For example, Dempsey and Laber (1992) argued that the theory of building a dividend policy on the assumptions of a perfect capital market, with not transaction costs for buying and selling is not practical. In a similar vein, Shefrin and Statman (1984) asserted that dividend irrelevance hypothesis is built on the assumption that the investor is rational when taking decisions, whereas psychological tests prove that human beings are not 100% rational with regard to decision making. Finally, Arnold (2008) observed that capital markets are imperfect in the sense that information is neither costless nor universally available to all shareholders. Consequently, when the restrictive assumptions of the Miller and Modigliani's (1961) dividend irrelevance argument are relaxed, dividend policy in fact does matter. Therefore, to accommodate the world in which market imperfections exist, financial economists have proposed numerous theories to explain why firms pay dividends: signalling, agency costs, tax-preference/clientele, the bird-in-the-hand theory, life-cycle theory, and catering theory. However, despite the profusion of these theories, the dividend policy still remains a puzzle as no single theory on its own completely explains the observed dividend behaviour of firms (Black, 1976; Allen and Michaely, 2002; Baker *et al.*, 2002; Brealey *et al.*, 2008). This evidence has rekindled the debate over the dividend puzzle. Nevertheless, in terms of overall conclusion, four standard explanations on why firms pay dividends can be identified from the literature.

The first explanation for paying dividends is based on market imperfections due to information asymmetry. The signalling hypothesis for paying dividends suggests that given

the presence of information asymmetry between managers and shareholders, managers may use dividends to signal to investors' private information about the state of affairs of the business, earnings growth and future prospects of the firm (Bhattacharya, 1979; John and Williams, 1985; Miller and Rock, 1985). The central theme of all the dividend signalling models is that "managers have private information about future prospects and choose dividend levels to signal that private information" (Lease *et al.*, 2000, p.97). The suggestion is that dividends serves as a signalling mechanism to mitigate information asymmetry between corporate insiders and outside shareholders. Therefore, a change in dividend conveys unique information as a reflection of management expectations about underlying company performance, financial strength, and earnings growth. Consequently, dividend increases convey positive information about future prospects, while dividend decreases convey negative information to the market about the company's performance (Petit, 1972; Aharony and Swary, 1980; Lonie *et al.*, 1996; McCluskey *et al.*, 2006; Al Yayhaee *et al.*, 2011).

The second explanation for paying dividends is based on agency costs, which stems from agency relationship due to separation of ownership and control between managers and shareholders. The separation of ownership and control may result in conflicts of interest between managers (agents) and shareholders (principals) because management may not always act in the best interest of the firm owners (Donaldson, 1963; Jensen and Meckling, 1976; Jensen, 1986). In this context, Jensen (1986) argued that, managers motivated by compensation and human capital considerations have incentives to overinvest free cash flows even in the absence of profitable investment opportunities (free cash flow hypothesis). Specifically, managers may invest in unprofitable investments such as lavishing resources on corporate jets and hunting trips as well as by investing in unjustifiable acquisitions and expansions. This problem induces shareholders to incur agency costs to monitor managers' behaviour. Dividend payments help to mitigate the agency costs associated with separation of ownership and control (Jensen and Meckling, 1976; Rozeff, 1982; Easterbrook, 1984; DeAngelo *et al.*, 2004). Thus, the agency model of dividend policy predicts that dividend changes should be positively related to stock returns because a higher dividend level reduces managers' tendency to waste free cash.

The third explanation for paying dividends is based on the tax preference/clientele effect. The tax effect/clientele theory suggests that differentials in tax rates between dividends and capital gains lead to different clienteles as investors select firms whose dividend policies suit their tax preferences (Elton and Gruber, 1970; Miller and Scholes, 1978). Miller and Modigliani (1961) noted that market imperfections such as transaction costs and differential tax rates may influence the portfolio choices of individual investors. In this respect, since investors are interested in *after-tax* returns, the differential tax treatment of dividends and capital gains may make investors concerned about the form of return that they receive from their shares (Litzenberger and Ramaswamy, 1979; Poterba and Summers, 1984; Soter *et al.*, 1996; Bell and Jenkinson, 2002). In particular, investors in low tax brackets may be attracted to high and stable dividends, because the transaction costs associated with selling stocks might be significant for such investors. On the other hand, investors in relatively high tax brackets may prefer low dividend payouts to avoid the transaction costs associated with reinvesting the proceeds of dividends (Al-Malkawi *et al.*, 2010). Consequently, taxation and transaction costs may create investor clienteles such as tax minimisation clientele, for example, institutional investors. As a result, clienteles such as institutional investors tend to be attracted to invest in dividend-paying shares due to the favourable tax treatment (Allen *et al.*, 2000). In addition, legal restrictions in institutional charters (such as the “prudent man rule”) prevent institutional investors from investing in non-paying or low-dividend stocks, which makes dividends appealing to institutional investors (Brav and Heaton, 1997).

Finally, the traditional argument in favour of dividend distributions is the bird-in-the-hand theory. This theory suggests that shareholders distrust management and fears that retained earnings will be wasted through poor investment decisions, leading to excessive management salaries and benefits. The bird-in-the-hand argument, therefore, asserts that by paying dividends the firm brings forward its cash inflows to shareholders, thereby reducing the uncertainty associated with future cash flows. The proponents of this theory argued that since dividends are less risky than capital gains, investors place value on the tangible nature of dividends relative to a possible capital gain (Gordon, 1963; Walter, 1963). Therefore, distribution of cash in the form of dividends increases firm value because dividends represent a certainty while share appreciation is uncertain (Gordon, 1963). This

preference explains why firms continue to pay dividends to shareholders despite the tax consequences associated with such a disbursement.

Despite the lack of consensus among academics on the impact of dividend payments on firm value, practitioners behave as if dividend policy does matter and companies to continue to pay dividends to shareholders. In a classical study based upon interviews with 28 corporate managers in the US, Lintner (1956) reported that managers' smoothen dividend payment streams and that companies are reluctant to cut dividends or increase dividends to a level that cannot be sustained. Similar survey evidence for firms in the US by Baker *et al.* (1985), Baker and Powell (1999) and Brav *et al.* (2005) suggest support for Lintner's dividend setting process in that managers try to maintain an uninterrupted record of dividend payments, have a target payout ratio, and periodically adjust the payout towards this ratio. McCluskey *et al.* (2007) interviewed the financial directors of Irish firms and reported that firms follow a policy in which dividend reductions are anathema and that dividends are increased only if management are convinced that the new dividend level can be maintained. Very recently, Chazi *et al.* (2011) surveyed the Chief Financial Officers (CFOs) of publicly listed firms in the UAE and reported that the determinants of dividend policy appears strikingly similar to those identified in Lintner's (1956) in that firms are unwilling to reduce dividends and typically determine their payout policy based on current earnings and past dividend payments. Similar survey evidence from the UK (Dhanani, 2005), Norway (Baker *et al.*, 2006), Barbados (Robinson, 2006), Canada (Baker *et al.*, 2008), and Pakistan (Khan *et al.*, 2011) suggest that managers from other countries hold similar views.

Numerous empirical studies have also documented that share prices react to dividend announcements, which suggests that dividends contain information relevant to price formation (Petit, 1972; Charest, 1978; Aharony and Swary, 1980; Easton, 1991; Lonie *et al.*, 1996; McCluskey *et al.*, 2006; Al-Yahyaee *et al.*, 2011; Dasillas and Leventis, 2011). The results of these studies support the notion that share prices follow the same direction as the dividend change announcements; dividend increases (decreases) are associated with significant increases (decreases) in share prices. For example, Petit (1972) conducted an empirical analysis of the information content of dividends using 1,000 monthly and 135 daily dividend announcements of 625 US firms. The author demonstrated that positive (negative) changes in dividend payments induce positive (negative) abnormal returns. This result

provides ample evidence that an announcement of a dividend increase is associated with an increase in share prices, while an announcement of a dividend cut leads to decrease in share prices. The implication is that dividend increases represent positive information about the company's prospects, while a dividend decrease is a negative signal about the company's future prospects.

Despite the volume of research that documented evidence that dividends do convey private information to the market, there is still considerable controversy about whether abnormal returns in share prices can be attributed to dividend announcements alone. Researchers have uncovered the fact that dividend news is not disclosed in isolation, but is instead published at the same time as other data such as earnings data, earnings forecast, capital expenditure announcements, *etc.* The impact of complex signals on share values has been examined extensively in the literature and a new strand of the signalling literature-based upon *interactive signals*- has rapidly developed (Kane *et al.*, 1984; Liljeblom, 1989; Easton, 1991; Lonie *et al.*, 1996; McCluskey *et al.*, 2006; Al-Yahyaee *et al.*, 2011). The results of these studies indicated that unexpected earnings and dividend announcements appeared to induce abnormal returns and when dividends and earnings were both increased, the stock market reaction was more favourable than when one variable increased in isolation, although the dividend signal appeared to dominate.

To date, there are only three studies on the stock market reaction to dividend announcements in Nigeria, despite the country's rapid growth and distinctive taxation structure: Olowe (1998), Adelegan (2009), and Campbell and Ohuocha (2011). Olowe (1998) examined the share price reaction to stock dividends around ex-dates in Nigeria from 1981 to 1992 employing monthly data. The author reported that share prices react to stock dividends before and after the ex-dates. Adelegan (2009) investigated the stock market reaction to the announcement of dividend payments and omissions for 742 announcement dates. The study reported a positive mean excess returns for the dividend paying firms and a negative mean excess returns for the dividend omitting firms. Campbell and Ohuocha (2011) examined the impact of stock dividends on the share prices of Nigerian companies from 2002 to 2006 using daily data. The authors documented support for both the cash substitution hypothesis and the signalling hypothesis. However, none of these prior studies examined the impact of cash dividend announcements on share prices of Nigerian

companies; instead, they have investigated the market reaction to either stock dividends alone or both cash and stock dividends in a single study. The current study investigates the stock market reaction to cash dividend announcements by companies listed on the Nigerian stock market from 2008 to 2012, taking into account the effect of other announcements that occurred before the cash dividend ex-dates, such as interim and stock dividends.

1.2 Motivations for the Study

There are many important motivations for the decision to investigate the dividend policy and stock market reaction to dividend announcements in Nigeria. First, despite the extensive theoretical and empirical research devoted to solve the dividend puzzle, a complete understanding of the factors that influence dividend policy is yet to be established. Moreover, a major part of this puzzle stems from the fact that firms continue to pay dividends despite the clear tax disadvantages associated with such disbursements. 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 position reinforces Black’s (1976, p.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”. Therefore, corporate dividend policy still remains one of the most controversial areas in modern finance calling for further theoretical and empirical research (Bernstein, 1996; Allen and Michaely, 2002; Dhanani, 2005). The current thesis seeks to contribute to the dividend debate in order to improve our understanding of the theory and practice of dividend policy.

Second, a review of the literature suggests that most research on dividend policy have focused almost exclusively on countries with developed capital markets, such as the US, UK, Australia, Canada and Republic of Ireland. Very little analysis has focused on emerging stock markets of sub-Saharan Africa, such as Nigeria. As a result, there is limited knowledge about how firms in emerging markets make their dividend decisions. Interestingly, there are a number of reasons why the evidence documented for developed markets may not apply to emerging markets. The literature suggests that varying accounting standards and information environments across markets are likely to impact differently on the manner in which stock markets in different regions and countries react to information (Alford *et al.*,

1993). Specifically, emerging markets are characterised by less information efficiency, and are more volatile (Kumar and Tsetsekos, 1999). In addition, emerging markets differ from their developed counterparts with respect to their corporate governance institutions, taxation on dividends and capital gains, as well as ownership structure (Glen *et al.*, 1995). Finally, firms in emerging markets face more financial constraints compared to their counterparts in developed economies, and this may affect dividend policy (Aivazian *et al.*, 2003). The current thesis aims to contribute to the research on dividend policy from the perspective of a developing country such as Nigeria in an attempt to fill the gap in the literature.

Third, the dividend behaviour of financial and non-financial firms is often studied separately, despite the suggestion in previous studies of an industry influence on dividend policy (see Lintner, 1956; Baker *et al.*, 1985; Barclays *et al.*, 1995; Baker and Powell, 1999); exceptions to this generalizations include Baker *et al.* (2001) and Baker *et al.* (2008), who investigated the dividend behaviour of managers of financial versus non-financial NASDAQ and Canadian firms respectively. One consequence of this segregation is that we have limited knowledge about how the views of managers of financial versus non-financial firms differ on the determinants of dividend policy. This shortfall represents a significant gap in the literature of which the current thesis seeks to fill. The current study investigates the impact of industry classifications on the perceptions of managers of Nigerian financial and non-financial firms on various dividend policy issues. The current study therefore seeks to update and extend the results of prior studies on industry-related dividend effect.

Finally, the Nigerian investment environment is characterised by an untypical taxation structure, where dividends are taxable while capital gains are totally exempted from taxation. This unique tax system provides an interesting environment for research to investigate the actual motivation for paying dividends, despite the tax consequences associated with such a disbursement. Yet, the extant literature shows that all the previous studies on the dividend policy of Nigerian companies rely heavily on economic modelling approaches without an in-depth understanding of how managers behave and perceive dividends. To the best of the researcher's knowledge, there is no prior study that has investigated the perspectives of Nigerian corporate managers on dividend policy. In Nigeria, the main line of the research on dividend policy uses market data that can only explain

surface reality but cannot measure motivation, which is the underlying force behind generating such data (Baker *et al.*, 2008). To address this pitfall in the literature, the current thesis adopts both the behavioural and empirical approaches in the investigation of the factors that drive dividend decision and the impact of dividend announcements on share prices of listed companies in Nigeria.

1.3 Research Questions

This study investigates managerial perspectives on dividend policy and the impact of dividend announcements on share prices of listed companies in Nigeria. The key research questions are:

Question 1: What are the perspectives of corporate managers on the factors that drive dividend decision and the relevance of dividend policy to firm value in Nigeria?

Question 2: Do cash dividend announcements in Nigerian listed companies convey price-sensitive information to investors?

Question 3: Does the Nigerian stock market responds quickly and efficiently to corporate news about dividend payments?

1.4 Research Objectives and Methodological Approach

In broad terms, this study aims to provide additional evidence on the wealth effect of dividend policy from the context of an emerging market, such as Nigeria. Specifically, the study investigates Nigerian managers' views on dividends and also examines the stock market reaction to cash dividend announcements in Nigeria. The study has three main research objectives:

Objective 1: To investigate the perspectives of corporate managers on the factors that drive dividend decision and the relevance of dividend policy to firm value in Nigeria.

Objective 2: To examine how the Nigerian stock market reacts to company announcements about cash dividend payments in order to determine whether or not dividends convey price-sensitive information to investors.

Objective 3: To examine the speed of share price adjustment to information emanating from dividend announcements in order to determine whether or not the Nigerian stock market is efficient in the semi-strong form.

In order to accomplish these objectives, this thesis employed a mixed methods research design, consisting of both quantitative and qualitative approaches. Specifically, three studies were conducted to study the topic from different angles. The first study employed a postal questionnaire survey to investigate the perspectives of corporate managers on the factors that drive dividend decision and the relevance of dividend policy to firm value in Nigeria. In particular, the questionnaire sought the perceptions of the corporate managers on the factors that influence dividend policy, the dividend setting process, the relationship between dividend policy and firm value, and the four standard explanations for paying dividends: signalling, agency, tax and the bird-in-the hand argument. The questionnaire also considered the administration of dividend policy in Nigeria. The questionnaire survey instrument was first mailed to the CFOs of each of 191 companies listed on the NSE in mid-June 2012.

The second study employed an event study methodology to examine how the Nigerian stock market reacts to corporate announcements about cash dividend payments, in order to determine whether or not such dividends contain information relevant to price formation. The event study spanned a five-year period from 2008 to 2012; this time span coincided with spells of recession, recovery and boom in the Nigerian economy. Abnormal returns were estimated over a 21-day event window, using both the market model for the three sub-groups of dividend change news: dividend increase, dividend decrease and no change in dividends. The study also employed the market-adjusted return model as a robustness check and to test the sensitivity of the results of this study to beta estimation. The sample consists of 102 companies that made 252 firm-year cash dividend announcements, consisting of 109 dividend increases, 87 dividend decreases and 56 no change in dividends.

Finally, interviews were conducted with the financial managers of selected Nigerian listed companies with established dividend patterns to investigate their perspectives on various dividend policy issues. A total of 21 financial managers were interviewed, consisting of 8 financial firms and 13 non-financial firms. The companies selected for the interviews were

purposely chosen in order to probe further some of the responses from the questionnaire survey. The interviews with management therefore complement and expand further the analysis of the questionnaire survey evidence. The interview focused on: (i) factors that drive dividend decision; (ii) dividend conservatism; (iii) target payout ratio; (iv) residual dividend policy; (v) dividend signalling; and (vi) taxation. The interviews took place between December 2012 and March 2013 at the head offices of the selected companies in Nigeria.

1.5 Structure of the Thesis

This thesis investigates the wealth effect of cash dividend announcements in Nigeria, employing both the behavioural and empirical approaches. Specifically, the study seeks to ascertain the factors that drive the dividend decision of Nigerian listed companies and to examine whether cash dividend announcements create value for companies listed on the Nigerian stock market. The remainder of this thesis contains seven (7) further chapters as follows:

Chapter 2 describes the Nigerian economy and its financial system structure from 1960 to 2012 and also overviews the dividend payout process. The purpose of this chapter is to provide the context of the research environment where the current study is conducted. The chapter: (i) overviews the growth and development of Nigerian economy from independence to date; (ii) examines the structure of the financial system in Nigeria; (iii) discusses the evolution, liberalization, crash and performance of the Nigerian capital market from the period of the Structural Adjustment Programme (SAP) in 1986 to 2012; (iv) reviews the corporate taxation structure in Nigeria, especially as it applies to personal income from dividends and capital gains; and finally (v) overviews the dividend payout process in an attempt to provide the reader with a background knowledge of corporate dividend policy.

Chapter 3 reviews the literature on dividend policy with specific focus on the signalling power of information content of dividend announcement, the issue of taxation, agency considerations and the bird-in-the-hand explanations for paying dividends. It starts with an examination of the “dividend irrelevance” argument advanced by Miller and Modigliani (1961). The review extends its analysis to the theoretical framework for dividend relevance;

thus recognizing that corporate dividend policy matters in an uncertain economic environment characterised by market imperfections such as; (a) information asymmetry between managers and the outside investors; (b) differential tax treatment of dividends compared to capital gains; (c) conflicts of interest between agents (managers) and principals (outside shareholders); and (d) irrational behaviour of investors. The review also covers the prior empirical studies on the dividend relevance theories. It also reviews the literature on dividend behaviour of management, thus recognising that companies have continued to pay dividends despite the tax disadvantage of dividends relative to capital gains. The review also integrates the empirical literature on the semi-strong form capital market efficiency in relation to dividend policy in an attempt to provide a holistic background against which to judge the empirical findings of the current thesis.

Chapter 4 presents a discussion of the research methodology and methods underpinning the present study. It identifies the core philosophical assumptions that guided the decisions about the mixed methods research design adopted for the investigation of dividend policy and stock market reaction to cash dividend announcements by companies listed in the Nigerian stock market documented in chapters 5, 6 and 7 of this thesis. In the context of these assumptions, the justification for using the pragmatic research worldview and the rationale for employing both the quantitative and qualitative research approaches in the current thesis are explained. In addition, the chapter also provides a detailed discussion of each of the research methods employed in this thesis, which comprises of a questionnaire survey, a standard event study method employing the market model and semi-structured interviews.

Chapter 5 investigates the views of corporate managers regarding the factors that drive the dividend decision and the relevance of dividend policy to firm value in Nigeria using a mail questionnaire survey administered to the chief financial officers (CFOs) of the 191 companies listed on the NSE in mid-June 2012. Specifically, the questionnaire seeks to explain: (i) the factors that influence the dividend decision of Nigerian companies, (ii) how Nigerian companies determine the amount of dividends they pay to shareholders, (iii) the perceptions of Nigerian corporate managers about the relationship between dividend policy and firm value, and (iv) the views of corporate managers about the four standard explanations for paying dividends (signalling, agency, tax, and bird-in-the-hand

explanations). The chapter also examines whether the perceptions of managers from financial firms versus non-financial firms differ on various dividend policy issues.

Chapter 6 examines the share price reaction to cash dividend announcements on the Nigerian stock market. A standard event study methodology, employing the market model, was applied to determine the abnormal returns surrounding the announcement of cash dividends by a large sample of listed companies in Nigeria that announced annual cash dividends over the period 2008-2012. To investigate the information content of dividend announcements, the chapter divided the sample firms into three groups based on the changes in the dividend per share of the announcing companies: dividend increasing (DI); dividend decreasing (DD); and no change in dividends (DnC). This chapter also examines whether the Nigerian stock market is efficient in the semi-strong form sense.

Chapter 7 presents an analysis of interviews with the financial managers of 21 listed companies in Nigeria spread among various sectors of the Nigerian economy. The interview complements and expands the analysis of the questionnaire survey instrument. Central to these interviews is an examination of the perspective of financial managers on various dividend policy issues including the factors that drive the dividend decision, dividend conservatism, target payout ratio, residual dividend policy, dividend signalling, and taxation. Specifically, this chapter seeks to ascertain whether the information reported in Chapter 5 of this thesis which suggests that dividend payments signal to Nigerian investors about future prospects of firms and that dividend create value for companies listed on the Nigerian stock market is confirmed. In keeping faith with the research approach taken in chapter 5, the analysis of interviews examines whether managerial perceptions on various dividend policy issues differ between financial and non-financial firms.

Finally, **chapter 8** of this thesis summarises the results of the different investigations conducted in this thesis. The chapter highlights the main contribution of the thesis to both knowledge and practice of dividend policy, especially in the context of less-developed markets such as Nigeria. The chapter also identifies some of the limitations of the work in this thesis, and make recommendations about what future research might be conducted in this relatively under-researched area.

CHAPTER TWO

THE NIGERIAN ECONOMY AND ITS FINANCIAL SYSTEM

2.1 Introduction

Chapter one discussed the background and justification for this research, noting that the dividend policy literature had paid little academic attention to dividend policy research that addresses issues related to the development of emerging stock markets. The chapter also noted that although there had been a sustained academic interest in examining the dividend puzzle, the factors that drive the dividend decisions of financial and non-financial firms are often studied separately. Chapter one, therefore, concluded that the dearth of dividend research in emerging markets make an examination of the dividend policy of firms that operates in less-developed markets an interesting topic for investigation. The current thesis investigates the dividend decision of managers of Nigerian financial and non-financial firms and the impact of dividend announcements on the share prices of listed companies in Nigeria.

This chapter provides the research context in which the present study is conducted. An examination of the this context is essential because of the miraculous transformation of the Nigerian economy from a depressed and unfriendly investment environment during the military rule to an investment destination since the return to democratic rule in 1999. The chapter provides a synopsis of the background information about Nigeria and also overviews the growth and development of the Nigerian economy from Independence 1960 to 2012. Specifically, the chapter discusses the structure of the Nigerian financial system, as well as the contribution of the major participants in the financial system to the development of the economy. The chapter also provides a detailed analysis of the features of the Nigerian capital market including the evolution, participants, liberalization, crash, and performance of the market and also considers the corporate taxation structure in Nigeria, especially as it relates to dividend policy. Finally, the chapter gives an overview of the dividend payout policy.

The rest of this chapter is divided into six sections. Section 2.2 provides background information about Nigeria including the political system and geographical situation existing

in the country. A general overview of the Nigerian economy including the periods of pre-oil boom, oil boom, stabilization and structural adjustment, and guided deregulation is incorporated in section 2.3. Section 2.4 reviews the structure of the Nigerian financial system. The major characteristics of the Nigerian capital market such as the evolution, participants, liberalization, crash, and performance is discussed in section 2.5, while section 2.6 outlines the corporate taxation structure in Nigeria. Section 2.7 provides an overview of the corporate dividend payout policy, while section 2.8 concludes the chapter.

2.2 Background Information about Nigeria

The country known today as Nigeria was formerly a British colony. The colonization of Nigeria started in 1861, when the British firms called upon their government to take control of the Nigerian territory as a means of regulating the rising competition experienced from other European countries like France and Germany (Aremu, 2002; Falola and Heaton, 2008). In 1900, the Southern Nigeria was a British protectorate in the coastal areas of modern-day Nigeria. This protectorate was joined with the Lagos colony in 1906, and it became the Colony and Protectorate of Southern Nigeria. In 1914, the Southern Protectorate was amalgamated with the Northern protectorate to form a single colony of Nigeria by Sir Fredrick Lord Lugard (Falola and Heaton, 2008). This unification was done specifically for economic reasons rather than political, as it was intended to benefit the British. The major goal was solely to reduce colonial administration cost by consolidating the two civil service operations of the Southern and Northern protectorates into one. Consequently, some analysts have argued that the unification of the Southern and Northern protectorates was a monumental error, as it has led to the entrapment within the same country of ethnicities that would otherwise never have been in union with one another (Fabiyyi, 2014).

Nigeria attained independence from the British colonial government on October 1, 1960, as a federation of three regions (northern, western and eastern) under a constitution that provided for a parliamentary system of government. Under the constitution, each of the three regions retained a substantial measure of self-government. The Federal government was given exclusive powers in defence and security, foreign relations, and fiscal policies. In October 1963, Nigeria altered its relationship with the United Kingdom by proclaiming itself

a Republic and promulgating a new constitution. Consequently, Dr. Nnamdi Azikiwe became the President, while Alhaji Tafawa Balewa was the Prime Minister. In the same year, a fourth region known as the Midwest region was established.

Unfortunately, the democratic system in Nigeria has been unstable due to frequent military interventions in governance of the country. For example, the first democratic process was subverted by the Nigerian military on 15th January 1966, when a small group of soldiers, mostly Igbos, overthrew the government and assassinated the Federal Prime Minister and the Premiers of the Northern and Western regions. This coup, seen largely by the North as specifically targeted at Northern soldiers led to a counter-coup by some Northern soldiers in July of same year. This counter-coup, which resulted in the massacre of thousands of the Igbos in the North prompted mass exodus of the Igbos from the North to the Southeast, and later resulted to a bloody civil war in May 1967, ending in the defeat of Biafra in 1970. In fact, Nigeria has been ruled by the military for 33 of the 54 years of its existence as an independent nation.

Nigeria returned to a democratically elected government in May 1999, ending the many years of military rule. Presently, Nigeria practices the presidential system of government. Under this system, the President is both the Head of State and the Head of the Federal Government, while the Governors are the chief executives in their respective states. Thus, the Nigerian president performs both ceremonial and real executive functions. The President is elected by all the electorates who are up to 18 years of age, while the state governors are elected by all the electorates in their respective states. Both the President and Governors are elected for a period of four years. Since the present democratic dispensation, Nigeria has been ruled at the centre by the People Democratic Party (PDP).

Nigeria is located in the Gulf of Guinea in West African region. The country is bordered by Benin to the west, Niger to the north, Chad and Cameroun to the east (See figure 2.1 below). Nigeria is popularly referred to as the “socio-political giant of Africa” due to its position as the most populous country in Africa and the largest producer of oil in the African continent (Rotberg, 2008). Nigeria is a federation of 36 states, 774 local government areas and the Federal Capital Territory (Abuja). In Nigeria, the last census was conducted in 2006. According to the census, the total area of Nigeria is 937, 052 square kilometres and the

population was about 140 million people (it is presently estimated to be over 175 million). The Census also indicates that Nigeria is nearly equally divided between Christianity and Islam. The official language of business in Nigeria is predominantly English; however, other national languages such Hausa, Ibo and Yoruba are also spoken. Nigeria has over 250 ethnic groups; the most significant groups are Hausa/Fulani, Yoruba, and Igbo (Adigan, 2006; Hakeem, 2006; Purefoy, 2006).

Figure 2.1 Map of Nigeria



Source: www.nationsonline.org

Nigeria is an oil rich country that has been weighed down by successive military regimes. The currency of Nigeria is the Naira (₦), and ₦1 consists of 100 kobo. The main exports of the country is oil and natural gas, and non-oil exports commodities such as cocoa, rubber, fish and shrimps, and cotton. Nigerian main export partners are: US (30% of total exports in 2009), Equatorial Guinea (8%), Brazil (6.6%), France (6%) and India (6%). From 2002 to 2010, Nigerian exports averaged 5.1 billion US dollars reaching an all-time high of 10.3 billion US dollars in May 2008 and a record low of 1.0 billion US dollars in February 2002. The country’s main export commodity is oil and natural gas and this account for more than 95

per cent of total exports. The country was previously the second largest economy in Africa (following South Africa), and has the tenth largest oil reserves in the world (Nigerian Review, 2010). In April 2014, Nigeria emerged the largest economy in Africa with a rebased GDP of about \$432 billion compared to that of South Africa which stood at \$370 billion at the end of 2013 (The Leadership, 2014).

Despite the abundance of oil reserves in Nigeria, several social and cultural issues still pose tremendous challenges to the development of the country. A strong division exists between the Hausa-Fulani, Igbo and Yoruba ethnic groups, while religious friction between largely Muslim population in the north and Christians inhabiting the south. The exploitation of Nigeria's ethnic, cultural and religious diversity has been blamed on politicians and other influential parties who use these means to further their selfish interest. The problem of social disharmony in Nigeria has been exacerbated by an escalation in the number of local militias, such as Niger Delta militants and Boko Haram terrorists group in the North. Before the granting of amnesty to the Niger Delta militants in 2010, this group had embarked on the kidnapping of oil sector workers in a fight to have a larger share of oil revenue from their region. Presently, the country has been encountering recent series of terrorists' attacks, which have been attributed to the Boko Haram in the North-East which are fighting to take over the presidency and Islamise Nigeria. This issue is a major challenge to the unity of Nigeria.

2.3 An Overview of the Nigerian Economy

This section gives an overview of the growth and development of the Nigerian economy from 1960 to 2012. During the pre-oil boom era (1960-1970), agriculture was the mainstay of the Nigerian economy. Agriculture contributed about 65 per cent to GDP and represented almost 70 per cent of total exports, despite fluctuations in world prices. Agriculture provided much of the foreign exchange that was utilised in importing raw materials and capital goods, the surplus of which was used by the government to develop infrastructure needed for long-term development. Nigeria became a major exporter of raw materials, comprising of agricultural produce and minerals to the industrialised nations. The Government adopted the Import Substitution Industrialization (ISI) strategy, which led to

the domestic production of various consumer items that were hitherto imported. During this period, the Gross Domestic Product (GDP) recorded 3.1 per cent growth annually, and the rates of inflation and unemployment remained relatively acceptable. For instance, the country never experienced double-digit inflation during the 1960s, while the unemployment rate was around 1.5 per cent and most visible among primary and secondary school leavers (Ekpo and Umoh, 2014).

During the oil boom era (1971-1977), the share of agriculture to GDP stood at 48.23 per cent in 1971, but declined to almost 21 per cent in 1977. Similarly, agricultural exports, as a percentage of total exports also reduced from 20.1 per cent in 1971 to 5.71 per cent in 1977. These effects on the agricultural sector was significantly due to the discovery of oil in commercial quantity in the 1950s, coupled with oil-boom resulting from the Arab oil embargo on the USA in 1973. From this period, the Nigerian economy became heavily dependent on oil, as oil revenue represented almost 90 per cent of foreign exchange earnings and about 85 per cent of total exports. Although the oil boom gave the government much needed revenue, it also created serious structural problems in the economy. For example, the oil boom resulted to increased rural-urban migration and decline in the production of agricultural commodities for export. As a result, the country became a net importer of basic foods from 1974. In an attempt to reverse the deteriorating food situation, the Government introduced the policy of Operation Feed the Nation (OFN), provided subsidies to peasant farmers and created more commodity boards for various agricultural and food products. These policies failed to arrest the ugly situation. Although the GDP recorded a remarkable growth rate of 10.5 per cent in 1976, the inflation rate was quite high during the same period. For example, the inflation rate reached 23 per cent in 1976, before declining to 16 per cent in 1977. For the same periods, unemployment rate was 4.3 per cent and 2 per cent respectively (Ekpo and Umoh, 2014).

Furthermore, Nigeria also witnessed the neo-Keynesian type management of the economy during the period of the oil boom, as the Government became directly involved in virtually all aspects of the economy, including the ownership and control of the petroleum and mining sectors, as well as direct involvement in banking, insurance, clearing and forwarding, with the enactment of the Nigerian Enterprises Promotion Decree in 1972 (Sanusi, 2002). This era was the genesis of Nigeria's problems, as primitive accumulation intensified

corruption, theft, real estate speculation, outright looting of government treasury and other fraudulent practices prevailed. During this period, the gap between the rich and the poor widened considerably. For example, the 100 per cent salary increase of 1975 was disastrous to the economy as prices escalated by more than 100 per cent. In addition, the exchange rate regime during this period encouraged imports; almost everything was imported, from toothpicks to toothpaste dispensers. During this period, the country saw deteriorating economic conditions as such as concurrent decline in GDP growth and the increase in inflation from 10.4 per cent to 20.3 per cent between 1975 and 1979 (Sanusi, 2002). Finally, the private sector also remained weak during the oil boom, as the existing macroeconomic policies continued to encourage consumption instead of production. The austerity measures introduced by the military administration under General Olusegun Obasanjo could not save the situation because structural problems were not addressed. Therefore, the Nigerian economy formally entered the recessionary phase during this period (Ekpo and Umoh, 2014).

The next phase in the growth and development of the Nigerian economy is the era of stabilization and structural adjustment (1978-1993). During this period, the global slump in oil prices resulted in an end to the oil boom and the consequent huge reduction in government revenue which was dependent on the oil industry. Between 1978 and 1986, the Nigerian economy continued to register negative growth rates; exceptions to these generalisations are 1979 and 1985 when the GDP showed positive growth. There were high inflation, high unemployment rate and fiscal imbalance in the country during this period. As a result, the Shehu Shagari Regime (1979-83) introduced stabilisation and austerity measures to arrest the deepening crisis. One of the measures introduced stringent control measures on exchange rate and import restrictions, as provided by the Economic Stabilization Act of 1982. However, despite the introduction of this measure, the poor performance of the economy continued. The balance of payment of the country worsened during this period due to increase in external loans by the government. The country's industrial capacity utilisation, which stood at 73.6 per cent in 1981, declined to 31 per cent in 1989. Similarly, manufacturing which grew at 14.6 per cent in 1981 reduced to 3.2 per cent in 1989 (NECMA, 2003; Ekpo and Umoh, 2014).

Consequently, in 1986, the Nigeria embraced the International Monetary Fund (IMF)-World Bank Structural Adjustment Programme (SAP), which influenced the economic policies of the government and led to reforms in the late 1980s and early 1990s. The objectives of these reforms were to radically diversify restructure and diversify the productive base of the economy, the pursuit of non-inflationary growth, privatisation of public enterprises, deregulation of the economy and achievement of external balance within two years (Yesufu, 1996; Mordi *et al.*, 2008). During the first two years of its implementation, these broad objectives were pursued with commitment. Later, as adjustment fatigue sets in, there was a relaxation of some measures between 1988 and 1989 in an attempt to cushion the adverse effects of the belt-tightening measures implemented in 1986 and 1987 (Mordi *et al.*, 2008). The introduction of SAP in Nigeria resulted to a very significant growth of the country's stock market due to the deregulation of the financial sector and the privatisation exercise which exposed investors and companies to the significance of the stock market (Soyode, 1990; Alile, 1996). However, until SAP was abandoned in 1994, the objectives were not achieved because of the inability of government to judiciously implement some of its policy measures (Oyefusi and Mogbolu, 2003; Donwa and Odia, 2010). Thus, the economic reform programme appeared to have intensified speculative and trading activities rather than increasing production. The private sector, which was expected to serve as an engine of growth failed to live up to expectations. Similarly, the proliferation of merchant banks, finance houses, de-regulation of interest rates, privatisation of the economy and the new industrial policy failed to attract the needed foreign direct investments. Hence, after eight years of the structural adjustment programme, the private sector was not able to respond adequately to the desire for increased production, employment and stable prices (Ekpo and Umoh, 2014).

During the period of guided deregulation (1994-1998), the Federal Government attempted to achieve a stable and realistic value of its domestic currency- the Naira. In 1995, the government introduced the dual exchange rate regime to redress the continued depreciation of the domestic currency. In addition, in 1996, the CBN intervened in the operations of the autonomous market to ensure that it was sufficiently funded. As a result, the real GDP grew steadily from N101.0 billion to N130.0 billion between 1994 and 1998. Similarly, the annual growth rates increased from 1.3 per cent in 1994 to 3.8 per cent in

1997, but dropped to 2.4 per cent in 1998. Given the estimated population growth rate of 2.83 per cent, the GDP growth rate of 2.4 per cent in 1998 implied that the average Nigerian citizen was worse off in terms of well-being than in 1997. This dismal picture was attributed partly to the contractionary monetary and fiscal policy measures, resulting from the International Monetary Fund (IMF) and World Bank initiatives for reduced public expenditure in the economy. During this period of guided deregulation, there was still high unemployment, as evidenced in the published unemployment rates of 3.2 per cent in 1994, 3.8 per cent in 1996, 2.6 per cent in 1997 and 14 per cent in 1998. Also, the rate of inflation during this period was alarming; this rate increased from 57.0 per cent in 1994 to 72.8 per cent in 1995, but fell to 29 per cent in 1996. The inflationary rate reduced drastically to 8.5 per cent in 1997, but rose marginally to 9.5 per cent in 1998. Therefore, the Nigerian economy failed to create enough employment opportunities for its citizens, and prices were generally unstable during the period of guided deregulation (Ekpo and Umoh, 2014).

The return to democratic rule in the country in 1999 brought about a renewed commitment towards achieving a stable and enabling economic environment for both domestic and foreign investment. Soludo (2007) noted that government emphasis on structural reforms, socio-political reconstruction, privatisation, and building a positive international image restored hope on potential investors to the country. One key feature of the civilian government is the increased tempo of development of the non-oil export sub-sector to enhance the contribution of non-oil exports to foreign exchange earnings as well as encourage the diversification of the economic base away from oil. Consequently, various measures were introduced to enhance the real sector productivity. In the agricultural sector for instance, the measures adopted included modernizing agricultural production, processing, storage and other practices by introducing new and improved seedlings. To achieve the target in the manufacturing sub-sector, the following steps were taken: implementation of the strategic industries initiatives that would ensure the diversification of the manufacturing base, privatisation of the state owned enterprises, establishment of small and medium enterprises (SMEs) development agencies to promote the development of SMEs, the sourcing of technical assistants for industrialists in the area of technology and capacity building, intensifying of economic diplomacy to attract foreign investors, rationalization of development finance institutions for effective credit delivery and

strengthening of the capital market. The Small and Medium Industries Equity Investment Scheme (SMIEIS) was established in 2001 to provide the much needed investment finance to the Small and Medium Industries (SMIs). This was in response to the need to fill the investment gap in the real sector of the Nigerian economy (Mordi *et al.*, 2008).

Another feature of the economic policy thrust of the new civilian government was the liberalization of the foreign exchange market through the adoption of several policy measures including Retail Dutch Auction System (RDAS) re-introduced in July 2002. The main objective of RDAS was to achieve a stable value for the naira. Before its introduction, the foreign exchange market was characterised by a wide premium between the official and the Bureaux De Change (BDCs) segments, round tripping, excessive demand for foreign exchange as well as exchange rate volatility. The RDAS achieved its objective as the exchange rate instability and volatility were reduced to a level that is bearable by the market. The RDAS also encouraged sanity in the market as many erring banks were sanctioned for malpractices and unprofessional conduct. Following the successes of the RDAS, the Wholesale Dutch Auction System (WDAS) was introduced in February 2006. The WDAS ensured further liberalization of the foreign exchange market which paved the way for mainstreaming many parallel market operations into the official window. Consequently, WDAS resulted in the achievement of stable naira exchange rate as well convergence of rates in the various segments of the foreign exchange market such that for the first time, the premium between the official and BDC rates was within the acceptable international standard limit of 5.0 per cent. The reform in the foreign exchange market accompanied with trade policy reforms was instrumental to the reintegration of the country into the global economy which paved the way for the increased inflows of foreign direct investment in the non-oil sector such as the communication sub-sector (Mordi *et al.*, 2008).

During the period (2003-2007), the Nigerian Government introduced an economic reform programme called the National Economic Empowerment Development Strategy (NEEDs). On a state level, NEEDs has its counterpart in the State Economic Empowerment and Development Strategy (SEEDs). The NEEDs programme is a medium term plan which was designed to achieve four main objectives: wealth creation, employment generation, poverty reduction and value re-orientation. Basically, the objectives of NEEDs are to be achieved through the creation of conducive macroeconomic environment, increased participation of

the private sector, promotion of domestic and foreign investments and economic empowerment especially gender mainstreaming, sustenance of high, but broad-based non-oil GDP growth rate that is consistent with poverty reduction and employment generation, diversification of the production structure away from the oil/mineral resources, ensuring international competitiveness of the productive sector as well as systematic reduction of the role of government in direct production of goods and strengthening its facilitating and regulatory functions. There is also the United Nations (UN)-sponsored long-term development programme called National Millennium Goals for Nigeria. This programme, which covers from 2000 to 2015, was designed at achieving a wide range of ambitious objectives including poverty reduction, gender equality, education, health, the environment and international development cooperation.

As a result of the above reforms, Nigeria's economic growth has averaged about 7.4 per cent annually from 2000 to 2011. The Nigerian economy recorded modest growth in 2012; the real gross domestic product (GDP), measured at 1990 basic prices, grew by 6.6 per cent, which was lower than the 7.4 per cent recorded in 2011. The lower growth in GDP relative to 2011 was attributed to the contraction in oil GDP. This growth was driven by the growth in the non-oil sector, particularly telecommunications, construction, wholesale and retail trade, hotel and restaurant services, manufacturing and agriculture. The non-oil sector has been a strong driver of growth in recent times- growing by over 9 per cent a year from 2004-2009, in marked contrast to the period 1997 to 2000, when it grew by just 3.5 per cent (Corporate Nigeria, 2012). Similarly, non-oil GDP grew by 8.5 per cent in 2010, 8.8 per cent in 2011 and 7.9 per cent in 2012 (CBN, 2012) (see Figure 2.1). Analysts believe that increased growth has been helped by the introduction of NEEDs, a medium-term plan which, in its second phase aims to drive growth by improving infrastructure through increased private sector participation. However, the economic growth has not cut poverty nor created necessary jobs for the teeming unemployed graduates roaming the Nigerian streets. For instance, About two-thirds of the Nigerian population lives on less than 1 US dollar (USD) per day and the unemployment rate in 2011 was 23.9 per cent, up from 21.1 per cent in 2010 (African Economic Outlook, 2012; Corporate Nigeria, 2012).

Despite the significant progress made in recent years, the country is plagued by a legacy of bad economic management, political instability, corruption, and inadequate infrastructure.

They argue that there are varying degrees of policy overturns, such as political instability and tensions, and communal/religious/ethnic violence been experienced in the country. The country's investment potentials are also adversely affected by poor business environment occasioned by unreliable power supply and transportation problems. Furthermore, a major problem of the business environment in Nigeria is the global image of high prevalence of economic crimes and corruption in the country. The combination of these problems dent the image of Nigeria as a potential investment destination, regardless of its overwhelming advantage in terms of population and gross domestic product (GDP) in Africa (Ogunkola and Jerome, 2006; Larossi *et al.*, 2009).

Figure 2.2 GDP Growth Rates 2008-2012



Source: CBN (2012).

In summary, Nigeria is considered to be a crucial player in Africa due to its size, oil resources and military strength. The emergence of democracy in Nigeria has been marked with improvements in various aspects of the economy. However, one of the major challenges to the Nigeria's economy is its over-dependence on the oil and gas industry. This sector, though essential to the country's economy, is responsible for 97.5 per cent of export revenues, 81 per cent of the government's budgetary revenues, but only accounts for 17 per cent of Nigeria's GDP. While this sector undoubtedly generates enough revenue for Nigeria, the drop in the oil revenue after the global financial crisis in 2008 has emphasized the need for the country to diversify its income streams. Non-oil industries including telecoms, financial services, and agriculture have performed significantly better than the oil and gas sector, especially during the period of the bubble burst. Moreover, the country's budgetary reliance on oil has resulted to unforeseen delays or even wholesale abandonment of capital

projects and delays in salary payment to civil service workers in periods of fluctuations in oil prices.

2.4. The Nigerian Financial System

CBN (2007) defines a financial system as the set of institutions, instruments, markets, the rules and regulations as well as the mechanism by which they interrelate to one another within the economic system. The financial system of a country plays a catalytic role in stimulating economic growth and development. The primary task of the financial system is the mobilization of funds from surplus economic units to the deficit economic units to produce goods and services and invest in new equipment and facilities in order to facilitate the growth and development of the economy and improve the standard of living of the citizens. Thus, an efficient financial system promotes production, capital accumulation, and growth by encouraging and mobilizing savings, and allocating them among alternative uses effectively.

The Nigerian's financial system is comprised of banking institutions, non-bank financial institutions, and financial markets. The Nigerian's banking sector consists of 24 deposit money banks, development finance institutions and other specialized finance institutions which include micro-finance banks, primary mortgage institutions, etc. The banks are generally in good financial condition due largely to close supervision by the CBN. Banks mobilize financial resources from the surplus sectors of the economy and channel funds to the deficit units of the economy through the extension of loans and credits. The non-bank financial institutions include non-deposit-taking financial institutions such as insurance companies, issuing houses, registrars, building societies, venture capital companies and the NSE. Thus, the major difference between banking and non-banking financial institutions is that while the banking institutions obtain their funds from deposits, the non-banking institutions obtain their funds from sources other than deposits.

Besides the banking and non-banking financial institutions, financial system operates through financial markets and institutions. CBN (2007) defines financial markets as the types of markets designed for the creation and disposition of financial assets. Thus, financial markets are institutional arrangements that facilitate the intermediation of funds in an

economy. The role of financial markets in economic development cannot be over-emphasized. Sourcing and efficiently managing of financial capital in a given economy is best facilitated by the existence and appropriate functioning of financial markets and institutions. Strictly speaking, financial markets perform two basic functions in an economy: the transfer of resources from inefficient sectors to modern and high productivity areas, and the initiation and stimulation of entrepreneurial activities in such efficient sectors (Yohannes, 1999).

In Nigeria, the financial market is segmented into two: money market and capital markets⁴ (CBN, 2007; Ikpefan and Osabuohien, 2012). The money market is the segment of the financial market that deals in short-term financial instruments or funds (Anyanwu, 1996; Dabwor, 2010). Money markets play a key role in banks' liquidity management and transmission of monetary policy. In normal times, money markets are among the most liquid in the financial sector. The banking system and the money market represent the exclusive setting monetary policy operates in. A developed, active and efficient interbank market enhances the efficiency of central bank's monetary policy, transmitting its impulses into the economy best (Rigg and Zibell, 2009). Thus, the development of the money market enhances the progress of financial intermediation and boosts lending to the economy, hence improving the country's economic and social welfare (Dabwor, 2010).

The money market is divided into two sectors: organized and unorganized. Oloyede (1999) defines an organized money market as a market for short-term investible fund where short-term financial instruments or liquid assets are bought and sold. The major significance of an organized money market is that it serves as the machinery for the mobilization of the country's financial resources for economic growth (Ikpefan and Osabuohien, 2012). In Nigeria, the main players in the money market are commercial banks, acceptance house, discount house and the CBN. The major instruments traded in the Nigerian money market are instruments that represent claims to Federal, State and Local Government Revenue funds such as treasury bills, Federal agency discount notes and principal notes. Others are instruments of non-governmental organisations like commercial banks and other financial

⁴ While the money market facilitates the provision of short-term funds to deficit spenders, the capital market is a market for long-term dealings in loanable funds. In strict terms, the basis of distinction between the money and the capital market lies in the degree of liquidity of instruments bought and sold in the each of the market.

institutions and they include negotiable certificate of deposit, commercial paper, bankers' acceptance and repurchase agreements.

On the other hand, the capital market can be described as the long-term end of the financial market. The capital market is a highly specialized and organized financial market set up to facilitate the mobilization and utilization of long-term funds, provide an investment avenue and speed up economic growth and development. It is a collection of markets and institutions, which facilitate the issuance and secondary trading of long-term financial instruments. Unlike the money market, which functions basically to provide short-term funds, the capital market provides funds for industries and the governments to meet their long-term capital requirements, such as financing for fixed investments- buildings, plants, bridges, etc. (CBN, 2006). The capital market is also divided into two sectors: unorganized and organized. The unorganized sectors include the indigenous money lenders and bankers, while the organized sector is broadly segregated into a gilt-edged market and the stock market.

The Nigerian capital market consists of two segments: the primary market and the secondary market. The primary market, also known as the 'new issue' market, is concerned with the raising of new funds. This market provides the mechanism for the sale of newly issued company shares to investors. The mode of offer for the securities traded in this market includes offer for subscriptions, rights issues, offer for sale, and private placement. In contrast, the secondary market exists for the sale and purchasing of existing securities that are already in people's hands, thus, enabling savers who purchased securities when they had surplus funds to recover their money when they are in need of cash. This consists of exchanges and over the counter deals where securities are bought and sold after their issuance in the primary market. This market performs a crucial role in the reallocation of existing assets between various investors. It also plays a key role in the determination of the cost of capital and the time horizons of corporate investors (Afolabi, 1991; Yohannes, 1999; Jalloh, 2009).

To sum up, a well-developed financial system is necessary in an economy because it enhances investment by identifying and funding good business opportunities, mobilizing savings, enabling trade, hedging and diversifying risk, and facilitating the exchange of goods

and services. The Nigerian financial system is made up of banking institutions, non-bank financial institutions, and the financial markets. In Nigeria, there are two segments of the financial markets: the money market and the capital market. The main focus of the current thesis is on the Nigerian capital market, where the data for the analysis of the impact of dividend announcements on share prices of listed companies documented in chapter 6 are taken from. As a result, the main features of the market such as the evolution, major participants, liberalization and performance need to be discussed in more detail. The next section did justice to this.

2.5 The Nigerian Capital Market

Al-Faki (2006) defines capital market as a network of specialized financial institutions, series of mechanisms, processes and infrastructure that facilitate the bringing together of suppliers and users of medium to long-term capital for investment in socio-economic developmental projects. Capital market is crucial in the mobilization of long-term capital or resources to firms with relatively high and increasing productivity, thus enhancing economic expansion and growth. The importance of capital market as an efficient channel of financial intermediation has been documented in numerous studies (Osamwonyi, 2005; Afees and Kazeem, 2011; Kolapo and Adaramola, 2012; Odetayo and Sajuyigbe, 2012). Since capital market is essential for long-term growth capital formation, it can be regarded as the driver of economic growth and development of any economy (Osaze, 2000). This section discusses the development of the Nigerian capital market from its inception to 2012. Specifically, it highlights the historical evolution of the Nigerian capital market, discusses the major participants in the market, the liberalization of the market, the market crash of 2008, and the performance of the market. It also examines the market indices including the All-Share Index and the various sectorial indices used in the sectors that make up the market.

2.5.1. Historical Development of the Nigerian Capital Market

The historical evolution of the Nigerian capital market can be traced back to the 1950s when the British Government ruling Nigeria at the time sought funds for running the local administration. During the colonial rule, most of the funds used in running the government were derived from agriculture, produce marketing and solid mineral mining. When the

British Government discovered that these sources were inadequate to meet its growing financial obligations, the colonial administration decided to expand its revenue base by reforming the system of revenue mobilization, taxation and other payments. It also saw the need to raise funds from public sector to cover temporary shortfalls in funds availability. Hence, the colonial government found it essential to establish a financial system by setting up the basic infrastructure for its take-off pending the development of an organized private sector (Osaze, 2007, Ewah *et al.*, 2009).

In line with the above argument, the first step towards the development of the Nigerian capital market was to secure the necessary finance for the development of this infrastructure and long-term capital project. This the colonial government did in 1946 when it promulgated the 10-year plan Local Loan Ordinance for the floatation of the first N300,000, 3% Government stock 1956/61 with its management vested on the Accountant-General (Odife, 2000). This was followed by the enactment of the Government and Other Securities (Local Trustees Powers) Acts in 1957, which specified the types of securities in which trust funds may be invested. In addition, the colonial government set up the Professor Barback committee to examine the ways and means of fostering a stock market in Nigeria. This committee recommended, among others, the creation of facilities for dealing in shares, the establishment of rules regulating share transfer and measures for encouraging savings and issues of securities of government and other organizations. The recommendations of this committee led to the promulgation of the General Loan and Stock Act and the Local Loan (Registered Stock and Securities) Act by the colonial administration at the end of the year 1957 (Osaze, 2007). The purpose of these legislations was to establish the legal and infrastructural framework for the take-off of a viable capital market in Nigeria.

In May 1958, the Federal Government of Nigeria through its ministry of industries set up the Barback committee to fashion out ways and means of promoting a stock market in Nigeria. Prior to this period, financial operators in Nigeria comprised mainly of foreign owned commercial banks that provided short-term commercial trade credits for the overseas companies with offices in Nigeria. Upon the recommendation of the Barback committee, the Nigerian capital market first came into existence on September 15, 1960 with the establishment of the Lagos Stock Exchange to provide a market place in which long-term capital could be raised and in which stocks could be traded. The Lagos Stock Exchange was

incorporated as a private limited liability company under the provisions of the Lagos Stock Exchange Act 1960. The Exchange commenced business on June 5, 1961 with 19 listed securities made up of 3 equities, 6 Federal Government Bonds and 10 industrial loans. The Exchange was given initial financial backing by the CBN in the form of annual subventions (Soyode, 1991; Nwankwo, 1991; Yohannes, 1999; CBN, 2010).

In 1977, the Lagos Stock Exchange was renamed and reconstituted into the NSE by the Indigenization decree of 1977 following the recommendations of the Industrial Enterprises Panel (Adeosun Panel) of 1975 that branch exchanges should be established. As a result, additional branches were opened in Kaduna (1978), Port Harcourt (1980), Kano (1989), Onitsha (1990) and Yola (2002). Each branch has a trading floor, which creates opportunities for buying and selling securities. On April 1, 1978, the Securities and Exchange Decree was promulgated to replace the Capital Issues Commission and expand the scope of its activities following the recommendations of the Financial System Review Committee (Okigbo Committee) of 1976. The Committee also recommended the establishment of multiple exchanges and the approval of share allotments by the SEC. The defunct Bendel State of Nigeria floated the N20 million 7% first Bendel State Loan as the first state government revenue bond in 1978, to finance the state government's housing development programme (Osaze, 2007).

In Nigeria, the growth and development of the capital market was influenced by series of government policies (Nwankwo, 1980). First, the government gave the impetus for the growth and development of a stock exchange through the Stock Exchange Act of 1961. The government also instituted a number of positive measures aimed at stimulating the growth of the capital market. A good example of such measure was the indigenization of the credit base objective (Ogege and Ezike, 2012). Also, the huge investments in second and third development loan stock issues in 1961 and 1962 are a ready case in point (Nyong, 1996). Second, the government through the Income Tax Management Act No. 21, 1961 mandated all existing pension and provident funds in the country to invest at least one-third of their funds in Nigerian government stocks at the penalty of forfeiting valuable tax concessions. Furthermore, pension and provident funds established after 1961 were required under the Act to invest at least a half of their funds in these stocks. This explains the consistently huge investment of these funds in government stocks (Nzotta, 2004). Finally, the insurance of

Miscellaneous Provision Act, 1964 also stimulated capital market growth in Nigeria in that the Act mandated all insurance companies operating in the country to invest locally at least forty per cent of the premium received on locally insured risks in the financial year (Nzotta, 2004).

In order to be at par with the developed nations, the Nigerian capital market regulators have recently initiated a number of reforms aimed at making the market attractive and vibrant to both domestic investors and operators and their foreign counterparts alike. The market recently introduced an Automated Trading System (ATS) for transactions in phase with international standard. The system is aimed at facilitating speedy trading and clearing at the capital market. The ATS which is an online, screen based integrated system is capable of performing multiple functions, being equipped with equity, debt and depository modules (CBN, 2000; Onoh, 2002). This system interfaces with the Central Security Clearing System (CSCS) which was also introduced in 1998 to reduce the time it takes to transact and deliver shares to investors. The CSCS, an automated clearing, settlement and delivery system was aimed at easing transactions and fostering investors' confidence. The introduction of both the ATS and the CSCS is aimed at improving the efficiency of trading, transparency in capital market, realistic pricing of securities, and generation of new opportunities for dealing members. Moreover, another important reform is the linking of performance information on the NSE to Reuters International System in order to disseminate relevant market information to subscribers.

To further deepen the Nigerian capital market, Decree No. 45 of 1999 was promulgated to restructure and widen the functions and powers of the Nigerian Stock Exchange Commission (NSEC). With the promulgation of the Decree, the NSEC was then saddled with the responsibility for establishing a commodity exchange, future markets, derivatives and any other exchanges which the commission considers desirable. The exchange has various benefits for members. Onoh (2002) noted that members of the exchange can deal on the floor of the exchange or with the clients of the exchange, who deal through brokers registered with the exchange. However, the Nigerian capital market is still characterised by illiquidity which deters foreign investors from investing in the market. Oluwatosin *et al.* (2013) noted that illiquidity and high transactions costs hinder the capital raising efforts of larger domestic enterprises and may push them to foreign markets.

In summary, the Nigerian capital market is saddled with the responsibility for the mobilization and efficient allocation of capital for investment purposes. The market puts in place structures for the mobilization of savings from surplus economic units and channels these resources to the deficit economic units for the purpose of stimulating the industrial and economic development of Nigeria. The market has been bedevilled with lots of problems which affected its performance. Some of these problems include stringent listing conditions, lack of awareness by investing public, poor economic conditions and loss of confidence by investors in the institutions operating in the market. These problems have resulted to divestment of funds to some other areas outside the capital market, where appropriate returns are envisaged. It is hoped that with the reforms put in place by the capital market regulators, the market can be revitalised to perform its duty of stimulating the growth and development of the country.

2.5.2. Major Participants in the Market

(a) The Central Bank of Nigeria (CBN)

The primary role of any central bank in an economy is to nurture an efficient financial system through the application of appropriate instruments to influence the levels of the monetary and credit aggregates in the pursuit of low inflation, economic growth and balance of payments viability (CBN, 2007). The clamour for the establishment of a central bank in Nigeria dates back to the period of the bank failures of the early 1950s. During this period, when the British colonial administration was still ruling Nigeria, the power of supervision of banks was vested in the Financial Secretary. The monetary role of a central bank as at that time was being played by the British Bank for West Africa (BBWA) and Nigeria witnessed the worst bank failures in the history of the country. As a result, many nationalist leaders at that time advocated for the establishment of a central bank to perform the traditional functions of a central bank which the then colonial administration resisted on the pretext of the absence of a highly organized money market. However, the strong-willed agitations by the nationalists led to the institution of several commissions to examine the desirability and feasibility of establishing a central bank in Nigeria as an instrument for promoting the economic development of the country. While the report of Mr. Fisher, an adviser to the Bank of England in 1952 and the International Bank for

Reconstruction and Development (IBRD) Mission in 1953 considered the establishment of a central bank in Nigeria as untimely, Mr. Loynes, also an adviser to the Bank of England in 1957 favoured the establishment of a central bank in Nigeria (CBN, 2007).

In March 1958, the draft legislation for the establishment for the establishment of the CBN was presented to the House of Representatives for consideration. The CBN was then established by the CBN Act of 1958 and commenced operations by July 1, 1959. The head office of the Bank was located in the administrative capital of Abuja, with branches. The CBN Act 1958 and the Banking Decree 1969 constituted the legal framework within which the CBN operates and regulates banks. The CBN powers was strengthened and extended to cover banks and non-bank financial institutions with the enactment of the Banks and Other Financial Institutions (BOFI) Decrees 24 and 25 of 1991, which repealed the Banking Decree of 1969. Unfortunately, in 1997, the Government of Nigeria enacted the CBN Amendment Decree No. 3 and BOFI Amendment Decree No. 4, which removed completely the limited autonomy which the Bank enjoyed since 1991. The autonomy of the CBN was later reversed by the promulgation of the CBN Amendment Decree No. 37 of 1998, which repealed the CBN Amended Decree No. 3 of 1997, thereby restoring a measure of operational autonomy for the CBN to carry out its traditional functions and enhances its versatility. The current legal framework within which the CBN operates is the CBN Act of 2007 which repealed the CBN Act of 1991 and all its amendments. This new Act reinforced CBN's mandate to ensure monetary and price stability.

The CBN is the apex regulatory authority in the Nigerian financial system. The CBN performs both the traditional and non-traditional functions of a central bank. The primary functions of the CBN include the issuance of legal tender currency notes and coins, maintenance of external reserves to safeguard the international value of the local currency, promoting monetary stability and efficient financial system. It is also the banker and financial adviser to the Federal Government and the lender of last resort to banks in the financial system. In addition to its core functions, the CBN also performs some developmental functions which include the promotion of the growth of money and capital markets, establishment of special schemes and funds, and establishment of the monetary policy forum to create a channel for cross fertilization of ideas between monetary authorities and other stakeholders (CBN, 2007).

In 2004, CBN's surveillance on banks revealed deterioration in bank's overall performance, based on CAMEL parameters. Out of the 87 banks in operation at the time, 10 banks were rated as strong, while 51, 16 and 10 banks were rated as satisfactory, marginal and unsound, respectively. Against this background, the CBN moved decisively to strengthen the industry, protect investors and creditors funds, safeguard the integrity of the industry and restore public confidence. Therefore, the CBN in July 2004 rolled out a 13-point reform agenda aimed at consolidating the banking sector and preventing the occurrence of systemic distress. One of the major elements in the reform package was the requirement that the minimum capitalization for banks should be N25 billion with effect from end-December 2005. This action forced several bank mergers and acquisitions (CBN, 2005; Onyema, 2012). The consolidation of the banking industry led to a sound and more secure banking system and reduction in systemic risks amongst others.

(b) The Securities and Exchange Commission (SEC)

The SEC serves as the apex regulatory body in the Nigerian capital market. The SEC which was established by the Securities and Exchange Commission Act No. 71 of 1979 was set up primarily to protect the interest of the investors and enhance capital market development in Nigeria. The Commission was further strengthened with the re-enactment of the enabling law, Decree No. 71 of 1979 as Decree No. 29 of 1988; this Decree made additional provisions to address observed lapses in the previous arrangement and to enable the commission pursue its function more effectively. Apart from the SEC Decree of 1988, which the commission administers, it also operates within the provisions of other statutory enactments that relate to securities business, corporate finance and investments in Nigeria. These enactments include Companies and Allied Matters Decree, 1990 which vests the administration of unit trust schemes in the SEC, the Trustees Investments Act of 1957 and 1962, and the Technical Committee and Privatisation and Commercialization Act 1988 (SEC Website, 2012).

To further enhance SEC's pursuit of its objective of investor protection, a review of the capital market was carried out by a 7-man panel headed by Chief Dennis Odife. Based on the panel's recommendation, a new Act known as the "Investment and Securities Act No. 45 of 1999" was promulgated on May 26, 1999. This Act repealed the SEC Act of 1988 and

conferred on the commission wide range regulatory powers over institution operating in the capital market. The new Act was expected to promote a more efficient and virile capital market, pivotal to meeting the nation's economic and developmental aspirations. The Investment and Securities Act was further reviewed, amended and subsequently passed into law in 2007. The SEC currently derives its powers from the Investment and Securities Act No. 29 of 2007.

The main functions of the SEC include: regulating and developing the Nigerian capital market; rule making, registration of stock exchanges, issuing houses and brokers, investigating all reports of violations or suspected violations of securities laws, enforcement of securities laws, review of accounts of companies covered by the SEC, approval and regulation of mergers and acquisitions, regulation of timing and amount of issues in the primary market, and market development (CBN, 2007; SEC Website, 2012). In order to perform these functions effectively, the operations of the SEC are divided among different divisions: securities investment, human resources, monitoring, legal, information technology, external relations, finance and accounts, administrative, enforcement, market development, financial standards and corporate governance and procurement division.

(c) The Nigerian Stock Exchange (NSE)

The Lagos Stock Exchange was incorporated as a limited liability company in 1960 to provide the mechanism for mobilizing public and private savings for productive investment in the economy. The NSE, which prides itself as the "Gateway to African markets", evolved from the Lagos Stock Exchange in 1977. The functions of the Exchange of the Exchange include: providing facilities to the public for the purchase and sale of stocks and shares of any kind, and controlling the granting of quotation on the Exchange in respect of shares and stocks. As at today, the Exchange services the second largest financial centre in sub-Saharan Africa. The NSE is also the third largest stock exchange in Africa by capitalisation and the largest and most active stock exchange in the West African region. The NSE is the centre point of the Nigerian capital market and provides a mechanism for mobilizing private and public savings, and makes such funds available for productive purposes. The Exchange also provides a means for trading existing securities (Hearn and Piesse, 2009; CBN Website, 2010).

The NSE is an automated exchange and provides listing and trading services as well. The Exchange also provides electronic Clearing, Settlement and Delivery (CSD) services through Central Security Clearing System (CSCS). The CSCS was introduced in 1998 to facilitate trading through enhanced processing and settlement of transactions. In 1999, the Automated Trading System (ATM) was introduced to enhance automation in the system. These efforts were geared toward improving the efficiency of the capital market and encourage foreign capital inflows into the economy. The NSE also offers market data dissemination services, market indices and much more. In order to enable small as well as large-scale enterprises gain access to public listing, the NSE operates two main exchanges- the main exchange and the Second-tier Securities Market (SSM). The main exchange is for relatively large companies, while the SSM where listing requirements are less stringent are for small and medium scale enterprises. Finally, the Exchange is poised to champion the acceleration of Africa's development (CBN, 2005).

The NSE hosts nearly 200 listed companies in twelve sectors, including Agriculture, Construction/Real estate, Consumer Goods, Financial Services, Healthcare, Industrial Goods, Information and Communications Technology (ICT), Natural Resources, Oil and Gas, Services, Utilities and Conglomerates. The NSE remains predominantly equities-driven market with certain sectors dominating trading and market capitalisation. On the Main Board, the Financial Services sector leads the pack with 30.82% of the board's total market capitalization; Consumer Goods are a close-second with 30.64%, and Industrial Goods account for 29.27%. In the Alternative Securities Market (ASeM), the exchange's small and medium enterprise board, Oil & Gas leads the pack with 73.69% of the board's market capitalization, while Services accounted for 13.73%. However, only 12 companies are listed on ASeM (NSE Website, 2011; Onyema, 2012).

(d) The Federal Ministry of Finance

The Federal Ministry of Finance (FMF) is the apex fiscal authority responsible for the formulation and regulation of fiscal operations in Nigeria, particularly, fiscal policy of the Federal Government (CBN, 2006, p. 14). The MFM is the supervisory authority for the SEC, NDIC and the National Insurance Commission among others. It was established in 1958 by the Finance (Control and Management) Ordinance to replace the then Finance Department.

The FMF is charged with the effective control and management of the public finance of the Federation. It coordinates its activities with those of the CBN to minimize conflicts and work in tandem with the monetary authority to ensure the achievement of macroeconomic goals of the government (CBN, 2006).

In the 1980s, the FMF went through various changes such as excising some of its departments or ceding others to it. In 1980, for example, the Budget Office became an Extra-Ministerial Department under the Executive Office of the President and headed by a Special Adviser to the President on Budget matters. From 1987, the Budget Office functioned once again under the Ministry of Finance and was supervised by its own Permanent Secretary. In 1988, the Office was merged with the Ministry of National Planning to form the Office of the Budget and Planning in the Presidency under a Ministry of State. Then in 1991, the Budget office was excised again from the Ministry of Budget and Planning and returned to the Ministry of Finance where it is to date (MFM Website, 2011).

The functions of the FMF include: (i) preparing annual estimates of revenue and expenditure for the Federal Government; (ii) formulating policies on fiscal and monetary matters; (iii) mobilizing domestic and external financial resources through both internal and external financial institutions, for developmental purposes; (iv) maintaining adequate foreign exchange reserves aimed at ensuring a healthy balance of payment position; (v) maintaining the internal and external value and stability of the Nigerian currency; (vi) supervising the insurance industry; (vii) managing revenue allocation matters; (viii) relating with relevant international organization and financial institutions such as Economic Commission for Africa (ECA), International Monetary Fund (IMF), United Nations Development Programmes (UNDP), Commonwealth Economic Committee, European Union/Africa, Caribbean and Pacific, Economic and Social Commission of the OAU, Economic Community of West African States (ECOWAS), etc. (MFM Website, 2011).

(f) Other Participants

Other participants in the Nigerian capital market include the stock broking firms, the issuing houses as well as the registrars. A stock broking firm is a firm that buys and sells securities on behalf of investors for a commission called “brokerage”. As an intermediary between the NSE and investors in the Nigerian capital market, a stock broker is charged with the

responsibility of educating the investors, generating data for accurate analysis and recommending stocks in an uncertain environment where stock prices hardly respond to the wider economic movements or changes. The NSE regulates the activities of stock brokering firms, including their commission charges. On the other hand, the issuing houses is one of the institutions in the capital market saddled with the responsibility of preparing prospectuses, packaging, timing, pricing, underwriting and the sale of new securities offered to the public by companies and governments. Finally, a registrar is an institution in the capital market that keeps the records in respect of quoted stocks and shares in the market. The duties of a registrar include: (i) acting as agents to the companies who appoint them; (ii) registration of the shares and the names of the owners in the shareholders' register; (iii) preparation of share certificates as well as sending them to the shareholders; and (iv) paying out approved dividend to shareholders (NSE, 2005).

2.5.3 Liberalization of the Market

Aluko (1980) defined liberalization as a process of enthroning private enterprises and market forces as the main determinants of resource allocation and abandonment of regulative role of government. To Akhiamiokor (1994), liberalization is the process of enthroning market forces as the determinant of resources allocation at the expense of government control. Thus, financial liberalization involves less administered interest rate structures, more competition among financial intermediaries, more market-based activity, more openings to cross border capital flows, and less 'repression' (Oladipo, 2000). Prior to the introduction of SAP in Nigeria in 1986, the Nigerian financial sector was characterized by fixed and relatively low interest rates. This resulted to financial disintermediation due to the low savings and demand deposits. Decline in financial intermediation leads to decline in the activities of the banking system since it is more crucial role of banks. In addition, the mandatory sectorial allocation of bank credit and the ceiling on bank credit to the private sector leads to distortion in credit allocation (Aklingunola *et al.*, 2013).

In 1986, Nigeria made the move towards liberalization when the country adopted SAP. The decision to undertake financial sector reforms in Nigeria could be partly attributed to the McKinnon (1973) and Shaw (1973) 'financial repression' and partly to the new thinking of the IMF and the World Bank as evident from the financial policies embodied in their

stabilization programme. McKinnon (1973) and Shaw (1973) suggest that a low or negative real rate of interest discourages savings and hence reduces the availability of loanable funds, constrains investment, and in turn lowers the rate of economic growth. They argued further that on the contrary, an increase in the real interest may induce savers to save more, which will enable investment to take place. Thus, the adjustment programme in Nigeria was geared towards the liberalisation of the financial markets, which has been recommended as a policy to overcome the problems of financial resources and generally involve interest rate deregulation and cancellation of the policy of directed credits (SEC, 2008; Aklingunola *et al.*, 2013).

Against this backdrop, Nigeria embarked on capital market liberalization in 1991. Consequently, several measures were geared towards liberalization of the foreign exchange markets, deregulation of interest rates, and adoption of a market-based pricing system amongst others (SEC, 2008). Specifically, interest rates were liberalized by switching from an administered interest rate setting to a market-based interest rate determination. In addition, credit controls were also removed by eliminating directed and subsidized credit schemes; thus replacing the use of credit ceiling with open market operation. Moreover, prudential regulations were also put in place, government owned banks were also privatized just as entry and exit from the financial sector were liberalized (Aklingunola *et al.*, 2013).

Henry (2003) opined that capital market liberalization comes along with substantial benefits such as increased market integration, low cost of capital, increased investment and increase in the chances of economic growth and development. During the last two decades after liberalization, there was an encouraging development in the growth of the Nigerian capital market. The market capitalization to GDP increased significantly from 4.2 per cent in 1988 to 11.5 per cent in 1994. Although it has levelled off somewhat, market capitalization was still over 9 per cent of GDP in 1977. Similarly, the total number of listed securities rose from 253 in 1988 to 276 in 1994. Finally, total market capitalization of listed companies increased from N10.0 billion in 1988 to N66.3 billion in 1994. However, some researchers have argued that the liberalization policies of the government did not bring about the desired benefits to the economy. For instance, Ariyo and Adelegan (2005) argued that although the liberalization of the capital market led to the growth of the Nigerian capital market, its impact at macro-economy was negligible.

2.5.4 The Market Crash of 2008

The Nigerian capital market had recorded remarkable growth levels before the global financial crisis which erupted in August 2007. The Nigerian stock market had been exceptionally bullish, with share prices soaring during the three-year period preceding the crisis. The effects of the crisis, however, started to manifest in the Nigerian stock market in the first quarter of 2008. The market capitalization nose-dived from an all-time high of N13.5 trillion to less than N4.6 trillion by the second week of January 2009. The All Share Index also plummeted from about 66,371 basis points to less than 28,848.40 basis points in the same period. In a similar vein, stock prices experienced a free-for-all downward movement during the period, with more than 60 per cent of listed securities on constant offer (supply exceeding demand) on a continuous basis. Thus, between March 2008 and the first half of 2009, the market depreciated as much as 56.5 per cent. As a result, many of the listed securities lacked liquidity as their holders were unable to convert them to cash to meet their domestic and investment needs (Akinso, 2009; Olisaemeka, 2009; Ikpefan and Osabuohien, 2012; Nwude, 2012).

The dramatic downward slides in the market indices have been blamed on a number of factors. UNECA, African Development Bank and African Development Fund Ministerial Conference on Financial Crisis (2008) attributed the crash to the shallowness of the financial sector of African economies, including Nigeria's. They argued that the financial system in Africa is weakly linked to the international financial system due to the shallowness of its financial sectors, and the illiquid capital markets. The Ministerial Conference on Financial Crisis (2008) then submitted that vulnerability of the global financial crisis on the African stock markets came through some financial linkages, including the receipt of approximately US\$15.73 billion in portfolio flows in 2007. Portfolio flows were then estimated to have declined to US\$5.7 billion in 2008. Given the small size of the Nigerian stock market, even small declines would lead to appreciable volatility.

Apart from the eruption of the global financial crisis, other factors agitated the crash of the Nigerian capital market. Sere-Ejembi (2008) argues that one issue that stirs the crash of the Nigerian stock market prices, in March 2008, is the subsequent plummeting of other market indicators. The author noted that risk-averse institutional and individual foreign investors

commenced divestment, to compensate for loss of investment in the global markets; this was supported by local investors with panic disposal. Also, the tightness in the balance sheets of the deposit money banks (DMBs) and counter-party risk also assisted the crash of the market. Other factors that contributed to the crash of the market apart from the speculative sub-prime mortgage bubbles include: (i) the margin lending by SMBs; (ii) stock price appreciation that had no correlation with the fundamentals in the quoting companies; and (iii) local investors opting to invest in foreign capital markets to take advantage of the low stock prices (Sere-Ejembi, 2008).

The political upheavals in African continent have also been cited as responsible for the crash of the Nigerian stock market. According to Nwude (2012), the political turmoil in some North African countries affected the trading activities on the NSE as major market indicators recorded significant declines as the war escalated. The author traced the losses recorded by the Nigerian stock market in 2011 to the unrest in some African countries and Middle East like Egypt, Tunisia, Algeria, Bahrain, Libya, Iran, Jordan and Yemen. The crisis in these countries resulted to a fresh round of withdrawal of funds by foreign investors, who account for a large proportion of investments in the Nigerian stock market. It is worthy to note that these foreign investors see Africa as a continent and are afraid that Nigeria can be affected by the crisis in its neighbouring countries in one way or the other.

The crash of the Nigerian capital market has been attributed to other factors which include: (i) the pronouncements by regulatory bodies such as the IMF that the CBN might need to increase benchmark rates further and weaken the domestic currency to curb inflation; (ii) the exorbitant cost of doing business in Nigeria; (iii) enforced regulations by the CBN on all banks to meet a minimum bank capital base of N25 billion, which forced banks to utilise the capital market to raise funds; (iv) unwholesome practices among Nigerian commercial banks, which include deceptive price manipulation in subtle agreement with stockbrokers and corrupt practices by some investors; (v) exit of foreign portfolio investors, orchestrated by the shrink in the foreign economies as more investors sought to make up for the deficits in their home countries; and (vi) borrowing from foreign banks (Olisaemeka, 2009; Nwude, 2012).

The meltdown of the Nigerian capital market is not without consequences. First, the crash resulted to loss of confidence in the Nigerian economy, as many investors preferred to convert the local currency into foreign currencies, especially the dollar and hold them through their domiciliary accounts. Second, the market meltdown led to credit crunch in the economy, as banks do not have enough to lend to the productive sectors of the economy. Third, the crash led to loss of confidence by banks and other lenders on shares as collateral for loan facilities. Fourth, the crash also led to massive erosion of investors' confidence on the regulatory bodies of the stock market whose impotence has been largely blamed for the present woes of the capital market. Fifth, the crisis made the stockbrokers financially incapacitated and unable to settle their clients for securities sold. Finally, the crash of the market resulted in an unstable macro-economic environment as the economy of the country remains unpredictable (Olisaemeka, 2009; Nwude, 2012).

To bring the Nigerian capital market back to its bullish state before the crisis, the Government put in place some measures to re-engineer the stock market to restore confidence to the investing public. Some of these measures include the reduction in the cash reserve ratio from 4% to 2%, monetary policy rate (MPR) from 10.25% to 9.75%, and liquidity ratio from 40% to 30% (Ikpefan and Osabuohien, 2012). Similarly, the apex regulatory authority in the capital market- the SEC introduced several measures, which were expected to tighten the regulatory regime, stabilise the volatile state of the market and prevent future malfeasance by the practitioners in the capital market. Specifically, the SEC amended the 'Rules and Regulations made pursuant to Investments and Securities Act (ISA) 2007. Some of the new rules released by SEC include: Book building and shelf registration, custodian of securities, regulations of securities clearing settlement and rules on market makers. In addition, the SEC collaborated with the CBN to issue guidelines on margin transaction, to forestall excessive margin lending- a major contributor to the financial crisis. The essence of these new rules, especially market makers rule, is to make capital market transactions more transparent and encourage new investors (Oladipo, 2013). The ten Market Makers include: (i) Stanbic IBTC; (ii) Renaissance Capital Limited; (iii) Future View Securities Limited; (iv) Velve Capital Limited; (v) Ess/Dunnloren Merrifield; (vi) WSTC Financial Services Limited; (vii) Capital Bancorp Limited; (viii) FBN Securities Limited; (ix) Greenwich Securities Limited; and (x) CSL Stockbrokers Limited.

The establishment of Market Makers in the NSE is a key initiative in the area of shoring up liquidity and depth in the equities market (Onyema, 2012). Through the provision of bid and offer prices in the trading system of a stock exchange, Market Makers provide liquidity to securities. They also ensure a fair and orderly market in their securities of responsibility and assist in the effective functioning of the overall market. It is therefore expected that the rules newly formulated by the SEC, will create a world-class capital market in Nigeria, as this is necessary to harness its natural and human resources. A robust Nigerian capital market will engender socio-economic development as it fosters meritocracy, good corporate governance, innovation and entrepreneurship, which in turn creates job opportunities that, will harness the skills and entrepreneurial zeal of the teeming Nigerian populace.

2.5.5 Performance of the Market

During its early years, trading activity in the Nigerian capital market was relatively weak. This was attributable mainly to the low level of information dissemination and awareness in the market. However, the market has become more efficient since the 1980s as a result of the level of computerization of trading and increased transparency in the dissemination of corporate information. Since then, the market has performed remarkably well, as evidenced from the major indicators of activity in the market. The improved performance of all the key market indicators in the 1980s was attributed largely to the establishment of the second-tier securities market (SSM) in 1985, the deregulation of interest rates in 1987, the privatisation programme of government-owned companies, enhancement in market infrastructure and requirements, innovations, as well as the banking sector reform (Adenuga, 2010). This subsection evaluates the performance of the Nigerian stock market from 1986 when the liberalization policy was introduced to 2012, using major market indicators including all-share index, number of deals, market capitalization, and the total number of listed securities. A visual inspection of table 2.1 shows that since 1986, most of the major market indicators have recorded significant growth.

All-Share Index: Stock market indices are used as general measures of performance of stock markets in terms of price appreciation or depreciation. These indices are important economic indicators, as they gauge the health, and very often, can predict the future

direction of economic activity (Ikoku and Okorie, 2010). The NSE's All-Share Value Index recorded a phenomenal growth from 163.8 in 1986 to 6,992.0 in 1996, 33,358.30 in 2006 and peaked at 57,990.22 in 2007, but declined to 24,770.52 in 2010 as a result of the effect of the global financial crisis which erupted in 2008. On November 24, 2011, the All-Share Index recorded its worst since the bubble burst in 2008, reaching its lowest point of 19,961.18 points, before rallying briefly at the tail end of the year to finish at 20,730.63 points. Specifically, the bench mark index finished in the red zone with a year-to-date return of 16.36 per cent (Ejiogu, 2012). In 2012, the All-Share Index climbed to 28,078.81 suggesting that the market is beginning to recover from the effect of the global financial meltdown.

Market Capitalization: This is the product of the total number of issued and fully paid shares of a company and its current price on a recognised exchange. The market capitalization is the most widely used indicator in assessing the size of a capital market to an economy. The market capitalization rises in a bullish market, while it falls in a bearish market. From 1986 to 1990, the total market capitalization was less than N20 billion. It hovered from N16.3 billion in 1990 to N472.3 billion in year 2000. In 2003, it was N1, 359.3 trillion and in 2004 it was N2, 112.5 trillion. It jumped over two-fold from N5, 121.0 trillion in 2006 to N13, 294.6 trillion in 2007, but this fell to N9, 918.2 trillion in 2010, due to the global financial meltdown which affected stock markets all over the world. In 2011, the market also had a bumpy ride in terms of market value, as investors lost N1.481 trillion as market capitalization of the 202 equities traded during the year declined by 17 per cent to close at N6.54 trillion as against N7.914 trillion recorded in 2010 (Ejiogu, 2012).

Number of Deals: The number of deals also increased from 27,718 in 1986 to peak at 49, 029 in 1992, before falling to 40,398 in 1993. It was 49,564 in 1995, but declined slightly to 49,515 in 1996, before rising to 78,089 in 1997. It later rose significantly from 123,509 in 1999 to 3,535,631 in 2008, and declined by -50.8 per cent to 1,739,365 in 2009. The 2010 to 2012 figures were not available.

Number of Listed Securities: When the Exchange was incorporated in 1961, the total number of securities listed was 8, comprising of 3 equities and 5 Federal Government bond that were previously listed on the London Stock Exchange (LSE). The total securities

increased from 8 in 1961 to 240 in 1986, 276 in 1996, 288 in 2006 and 301 in 2008. It later declined to 264 in 2010. The number of listed securities declined to 250 in 2011, but rose to 256 in 2012. Some of the major securities traded on the market during the period under review were government development stocks, industrial loans/preference shares, and equities. In terms of the listed securities, the number is still very low considering the fact that the Nigerian capital market has operated for more than 50 years.

Value of shares traded: The value of traded securities declined from N494.0 million in 1986 to N136.2 million in 1991 before rising to over N60 billion in 2002. The value of shares traded was N313.5 million in 1992, N569.7 million in 1994, N13.5 billion in 1998 and N28.1 billion in 2000. This figure climbed significantly to N2.3 trillion in 2008 before declining to N684.5 billion in 2009 as a result of the effect of the global financial crisis. The market recorded its lowest figure in 2010, where the total value of shares traded stood at N634.8 billion. In 2012, the Nigerian capital market recorded an increase in the value of shares traded, unlike most global stock exchanges. The value traded in 2012 was N657.77 billion, up 5.65 per cent, a reversal of the 20.39 per cent decline suffered between 2010 and 2011. This positive turnaround was due to the fact that local investors started coming back to the equities market, accounting for 44.3 per cent of the total market activity as at November 2012, up 38.38 per cent from 2011 (NSE, 2013).

Table 2.1: Selected Market Indicators 1986-2012

Year	All Share Index	Number of Deals	Market Capitalisation ₦'Billion	Total Number of Listed Securities	Total Value of Traded Securities ₦'Million
1986	163.8	27,718	6.79	240	494.0
1987	190.9	20,525	8.30	244	348.0
1988	233.6	21,560	10.02	253	137.6
1989	325.3	33,444	12.58	267	521.6
1990	513.8	39,270	16.36	295	265.5
1991	783.0	41,770	23.13	239	136.2
1992	1,107.6	49,029	31.27	251	313.5
1993	1,543.8	40,398	47.44	272	402.3
1994	2,205.0	42,074	66.37	276	569.7
1995	5,092.0	49,564	180.31	276	1,838.8
1996	6,992.0	49,515	285.82	276	7,062.7
1997	6,440.5	78,089	281.96	264	11,072.0
1998	5,672.7	84,935	262.52	264	13,572.4
1999	5,266.4	123,509	300.04	268	14,027.4
2000	8,111.0	256,523	472.90	260	28,154.6
2001	10,963.1	426,163	662.6	261	57,637.2
2002	12,137.70	451,850	764.9	258	60,088.7
2003	20,128.90	621,717	1,359.3	265	120,703.0
2004	23,844.50	973,526	1,925.9	277	225,820.5
2005	24,085.80	1,021,967	2,900.1	288	262,929.6
2006	33,358.30	4,021,780	5,120.90	288	470,253.8
2007	57,990.22	2,615,020	13,294.59	310	2,086,294.59
2008	31,450.78	3,535,631	9,563.0	301	2,379,142.70
2009	20,827.17	1,739,365	7,030.8	265	684,451.2
2010	24,770.52	NA	9,918.2	264	797,551.6
2011	20,730.63	NA	10,028.0	250	634,899.83
2012	28,078.81	NA	14,080.0	256	657,770.00

Source: Nigerian Stock Exchange, Securities and Exchange Commission Statistical Bulletin (various issues).

2.5.6 Market Indices

Stock market indices are used as a general measure of the performance of stock markets in terms of price appreciation or depreciation. These indices are important economic indicators, as they gauge the health, and very often, can predict the future direction of economic activity. Besides movements in the overall indices, investors and policymakers are also attuned to the performance of the different sectors of the economy which are represented by sectoral indices (Ikoku and Okorie, 2010). The main index used in the Nigerian stock market is the NSE All-Share Index, which is a market-capitalization-weighted index (a value-weighted index) of all shares traded on the NSE. This Index was formulated in January 1984 with a base value of 100 and only ordinary shares are included in the computation of the index. The index is value-relative and is computed daily.

In addition to the All-Share Index, the NSE also introduced five sectoral indices to enhance the trading and performance measurement among various sectors of the Nigerian equity market. Table 2.2 presents a summary of the market indices. The indices include: the NSE 30 Index; the NSE Banking Index; the NSE Insurance Index; the NSE Consumer Index and the NSE Oil/Gas Index. The indices were based on a number of criteria, including market capitalization and liquidity. While the NSE 30 Index is a capitalization-weighted index which tracks the performance of 30 most liquid stocks representing industry sector, the NSE Insurance Index provides an investable benchmark to capture the performance of the most capitalized and liquid companies in the insurance sector. Similarly, the other remaining three indices are based on the market capitalization methodology and are designed to provide investible benchmarks to capture the performances of the NSE Banking, Food and Beverage, and Oil and Gas sectors respectively. The indices started at values other than 100 at inception: the NSE 30 Index had a value of 563.4; the NSE Banking Index had a value of 297.78; the NSE Insurance Index had a value of 515.38; the NSE Oil and Gas Index had a value of 624.91 and the NSE Consumer Index (formerly Food & Beverage Index) had a value of 355.94 (Ikoku and Okorie, 2010, NSE Website, 2012).

Table 2.2 Indices

Index Name	Index Type (Price Index, Sector Index, etc.)
NSE All Share Index (ASI)	The NSE ASI (ALL Share Index) is a value-weighted market capitalization index. The start date for the NSE ASI is January 3, 1984; the base value is 100 points.
NSE 30	The NSE 30 Index comprises the top 30 equities in terms of market capitalization and liquidity. Only fully-paid common shares, denominated in the Nigerian currency (naira) are included in the index. The number of equities in the index is fixed at 30. The start date for the NSE 30 Index is January 1, 2007; the base value is 1,000 points. The index is rebalanced on a semi-annual basis, on the first business day in January and July.
NSE Consumer Goods Index (formerly Food/Beverage Index)	The NSE Consumer Goods Index is one-of-four indices designed to provide a benchmark to capture the performance of a specific sector. The number of stocks in this index is fixed at 15. The start date for the Consumer Index is July 1, 2008; the base value is 1,000 points. The index is rebalanced on a semi-annual basis, on the first business day in January and July.
NSE Banking Index	The NSE Banking Index is one-of-four indices designed to provide a benchmark to capture the performance of a specific sector. The number of stocks is fixed at 10. The start date for the Banking Index is July 1, 2008; the base value is 1,000 points. The index is rebalanced on a semi-annual basis, on the first business day in January and July.
NSE Oil & Gas Index	The NSE Oil & Gas Index is one-of-four indices designed to provide a benchmark to capture the performance of a specific sector. The number of stocks is fixed at 7. The start date for the Oil & Gas Index is July 1, 2008; the base value is 1,000 points. The index is rebalanced on a semi-annual basis, on the first business day in January and July.
NSE Insurance Index	The NSE Insurance Index is one-of-four indices designed to provide a benchmark to capture the performance of a specific sector. The number of stocks is fixed at 15. The eligible equity universe is the top 15 most capitalized and liquid companies in the insurance sector. The start date of the NSE Insurance Index is July 1, 2008; the base value is 1,000 points. The index is rebalanced on a semi-annual basis, on the first business day in January and July.

Source: ASEA Yearbook (2013, p.188).

The performance of the NSE All-Share Index and the sectoral indices between 2010 and 2012 are shown in Table 2.3. A visual inspection of the table shows that, the NSE All-Share Index and all the sectoral indices recorded negative performances between 2010 and 2011 due to the volatile market conditions orchestrated by the aftermath of the global financial crisis which erupted in 2008. The bubble burst marred investors' appetite for shares, as equity exposure were cut by funds and asset managers to cover positions in the US and

Eurozone (Onyema, 2012). During the period, the NSE All-Share Index declined by 17.07 per cent, from 24,770.52 points in 2010 to 20,730.63 points in 2011. Similarly, the five sectoral indices recorded negative performances during the same period; the NSE 30, the NSE Consumer Goods, and the NSE Banking Indices declined by 14.92 per cent, 26.70 per cent, and 34.69 per cent respectively during the same period. In addition, the NSE Insurance Index declined by 14.67 per cent, while the NSE Oil/Gas Index recorded 42.03 per cent decline during the period. However, in nominal terms, the NSE 30 and the Consumer Goods Indices had the best performances, while the Insurance Index performed worse during the period under review.

In 2012, the major index of the NSE (NSE All Share Index) closed the year with its strongest performance since 2008, while other indices topped their performances pre-global financial meltdown. Specifically, the NSE All Share Index gained 35.45 per cent, as the Bloomberg NSE 30 soared 44.63 per cent. Similarly, the NSE Consumer Goods Index grew 42.29 per cent, and the Bloomberg NSE Banking Index added 23.84 per cent to its 2011 value. However, a few indices mimicked the negative trends affecting their respective economic sectors, including the Bloomberg NSE Insurance Index which shed 17.45 per cent, and the Bloomberg NSE Oil/Gas Index which plunged 30.53 per cent. Table 2.3 also reveals that the market capitalization for all listed equities on the Main Board and the Alternative Securities Market (ASeM) rose by 37.36 per cent in 2012. Figure 2.2 gives a graphical illustration of the performance of the NSE All Share Index and the various sectoral indices from 2009 to 2011.

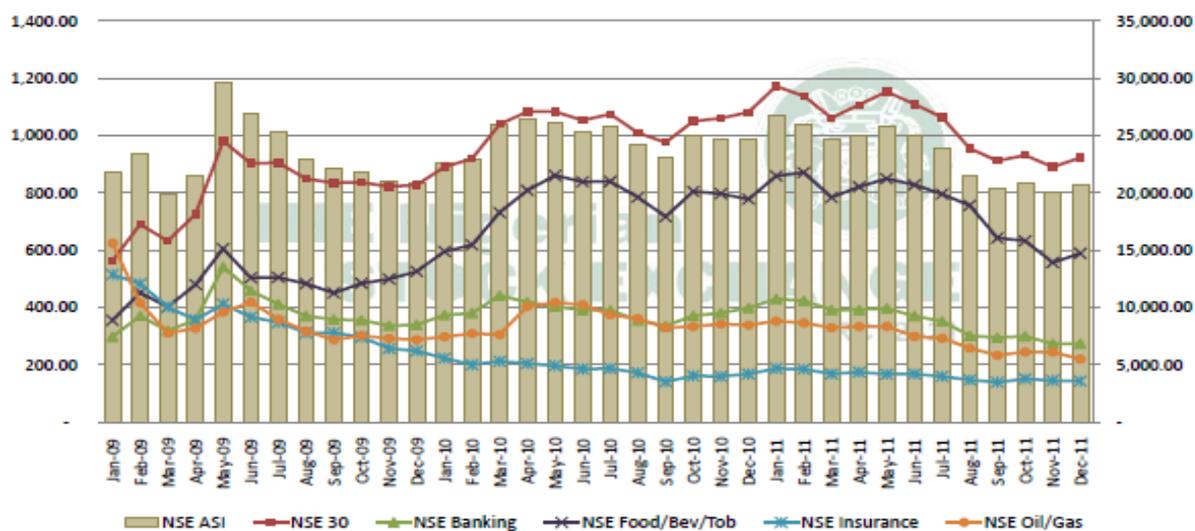
In summary, this section examined the performance of the Nigerian capital market from 1986 to 2012. It was observed that prior to 1986; activities in the market were very low due largely to low level of information and awareness in the market. However, from 1986, the market responded positively to the liberalisation policies of the government. During this period, the market witnesses increased modernization of its facilities. In addition, the deregulation of interest rates in 1987 stimulated keen competition in the financial system, thereby, resulting in many enterprises in the private sector approaching the market for funds. Since then, the market has witnessed remarkable growth in all-share value index, the number of listed securities, number of deals and market capitalization.

Table 2.3 Snapshot of NSE Market Indices 2010-2012

	2010	2011	2012	Change (2010-2011)	Change (2011-2012)
Market Capitalization (Equities)	N7.92 trillion \$53.40 billion	N6.54 trillion \$43.06 billion	N8.98 trillion \$95.32 billion	-17.42	37.36 %
NSE All Share Index	24,770.52	20,730.63	28,078.81	-17.07	35.45%
Bloomberg NSE 30 Index	1,081.95	923.77	1,336.07	-14.92	44.63%
Bloomberg NSE Food/Beverage Index	778.47	589.60	838.97	-26.70	42.29%
Bloomberg NSE Banking Index	399.08	274.26	339.63	-34.69	23.84%
Bloomberg NSE Insurance Index	168.34	143.54	118.49	-14.67	-17.45%
Bloomberg NSE Oil/Gas Index	338.85	220.11	152.92	-42.03	-30.53%
Total Volume (units)	93.34 billion	82.30 billion	89.15 billion	-4.03	8.32%
Total Value	N797.55 billion \$5.38 billion	N622.60 billion \$4.18 billion	N657.77 billion \$4.24 billion	-20.39	5.65%
Avg. Daily Volume (units)	377.87 million	334.54 million	339.50 million	-3.63	7.46%
Avg. Daily Value	N3.23 billion \$21.78 million	N2.58 billion \$16.99 million	N2.65 billion \$17.07 million	-20.12	4.74%

Source: Nigerian Stock Exchange (2012)

Figure 2.3 NSE Market Indices Performance 2009-2012



Source: Nigerian Stock Exchange (2012)

2.6 Corporate Taxation System in Nigeria

Tax is a compulsory levy imposed by the government of a country on individuals and corporate entities in respect of return of service expected from that government. In Nigeria, the recent changes in its corporate tax regime provide an interesting opportunity for an investigation of the impact of taxes on dividend policy in the country. Specifically, the taxation structure in Nigeria where personal income from dividends are taxable, while its equivalent from capital gains are totally exempted from taxation during the period of this study provides an ample opportunity to investigate why firms continue to distribute earnings in the form of cash rather than stocks, despite the tax consequences associated with such a disbursement. This section provides a brief review of the corporate taxation system in Nigeria, especially as it relates to the taxation of dividends.

As Nigeria is an oil-producing country, taxes play a minor role in generating income for the country. In Nigeria, the country's main tax is the companies' income tax, which was 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 in Nigeria was 35 per cent and it is applied on the chargeable profit of the company. Nigerian companies in the agricultural, mining, and manufacturing sectors with a turnover of less than N1 million for the first five years of operations are taxed at a flat rate of 20 per cent. New manufacturing companies that derive most of their revenues from export and mining enterprises are exempt from income tax for the first three years of operation. Petroleum companies are also eligible for a three-year tax holiday and significant incentives in the following years. The corporate tax rate was changed from 35 per cent to 30 per cent with effect from 1 January 1996. 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 (Nigerian Review, 2010; Onyeukwu, 2010; Ekeocha *et al.*, 2012; Federal Inland Revenue Service, 2012).

In terms of the taxation of dividends and other distributions, the Nigerian corporate tax system is skewed in favour of retention of profits for further investments. In Nigeria, any company paying dividends to its shareholders is first of all obliged to pay tax on its profits at the company's tax rate before distributing dividends to its shareholders. As a general rule, any dividend or other company distribution whether or not of a capital nature made by a Nigerian company is liable to a withholding tax at source of 10 per cent. However, dividends paid between two Nigerian companies are exempt from corporate income tax. On the other hand, any dividend paid by a company in the form of bonus/scrip share issue 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 company (Federal Inland Revenue Service, 2012).

⁵This system of taxation in Nigeria represents a classical tax system with double taxation of dividends and tax exempt capital gains. Tax-exempt individuals are expected to be indifferent between dividends and retained earnings.⁶ Hence, tax treatment of dividends in Nigeria favours the distribution of earnings in form of additional stocks than dividends. Thus, the current thesis seeks to ascertain why companies pay dividends in Nigeria, despite the tax consequences associated with such a disbursement.

The next section provides an overview of the dividend payout policy. It outlines the standard methods of cash dividend payment and the factors affecting cash dividend payment. The section also explains the mechanics of cash dividend payment. The purpose of this section is to provide the reader with a background of the corporate dividend payout process.

2.7 An Overview of the Dividend Payout Policy

Dividend policy refers to the corporation's decision to pay out a portion of its earnings to its shareholders as dividends. The dividend decision is considered a financing decision because the profit of the corporation is an important source of financing available to the firm (Lease

⁵ In Nigeria, stock dividends are known as bonus issues. They involve the distribution of additional shares to shareholders whose names appear on the company's register of members before a certain cut-off date (the ex-date) that is usually fixed by the company.

⁶ In Nigeria, corporations are the only category of shareholders for whom the tax system induces a preference for cash dividends as opposed to capital gains (FIRS, 2012).

et al., 2000; Brealey *et al.*, 2008). When a company declares cash dividend from its earnings, the funds leave the firm permanently and are irreversible. However, in the absence of dividends, corporate earnings accrue to the benefit of the shareholders as retained earnings and are automatically reinvested in the firm. The issue of dividend policy concerns the question of whether one of these approaches is more advantageous to the shareholders of a firm.

A company's decision about how much of its earnings to distribute to shareholders is often mixed up with other financing and investment decisions. This is because management has a variety of alternative uses of the earnings generated by a company. For example, some companies pay out little cash because management is optimistic about the firm's future and wishes to retain earnings for expansion. In this case, the dividend decision is a by-product of the investment decision. On the contrary, another company might choose to finance capital expenditure largely by borrowing, which releases cash that can be distributed to shareholders. In the latter case, the pay-out decision is a by-product of the borrowing decision (Brealey *et al.*, 2008). In a strict sense, therefore, a proper dividend policy decision involves a trade-off between retaining earnings on the one hand and selling new shares to obtain the cash to pay dividends on the other hand.

The responsibility of setting a company's dividends is vested in the Board of Directors. The decision on dividend payments is usually taken at the Annual General Meeting (AGM). The announcement of the dividend states that the payment will be made to all shareholders who are registered on a particular record date. The main concern of the managers is to suggest an acceptable and fair dividend for shareholders consistent with the rate of dividend decided by the company's management. As a result, in preparing dividend distribution, managers not only look at the current year profit but also at the expected future earnings, and more importantly the ability of the company to maintain a stable rate of dividend, taking into consideration the systematic growth of this ratio (Brealey *et al.*, 2008; Pike and Neale, 2009).

Cash dividend policy is the most common method of distributing profits to the shareholders of the company. A cash dividend is money paid to shareholders, normally out of the corporation's earnings or accumulated profits. A cash dividend can be expressed as either

dollars per share (dividends per share), a percentage of market price (dividend yield) or as a percentage of earnings per share (dividend payout). When a cash dividend is declared, the money is transferred to a liability account called dividend payable. This liability is removed when the company actually makes the payment on the dividend payment date, usually a few weeks after the ex-dividend date. Such dividends are a form of investment income and are usually taxable to the recipient in the year they are paid.

The announcement of a cash dividend is used to signal managerial confidence in the future performance of the company. Research has shown that the payment of a cash dividend affects the market value of firms, either by increase or decrease in firm value as reflected in the share prices (see, Petit, 1972; Watts, 1973). Since dividend policy is one of the factors that drive an investor's decision to purchase a stock, most companies announce their dividends and telegraph any expected changes in the policy to the public. The impact of cash dividend policy on the current prices of company's shares is considered to be very important, not only for policy makers, but also for investors, portfolio managers, and economists interested in the performance of capital markets (Okpara, 2010). Therefore, companies use dividend policy to provide information about company prospects, not otherwise available to investors.

2.7.1. Types of Cash Dividend Policy

Theoretically, there are different types of cash dividend policies a company could follow. These include constant or fixed dividend policy rate, progressive policy, residual policy, zero policy, and non-cash policy. Investors are seen to belong to a particular group or clientele. This is because they tend to pitch their tent with a particular policy that suits them. This is the clientele effect of dividend policy (Hutchinson, 1995; Kolb and Rodriguez, 1996). The clientele effect may occur because some individual shareholders prefer cash dividends, while others dislike cash dividends for tax reasons (Black and Scholes, 1974). Each of these policies is discussed in detail below.

Constant or fixed dividend policy rate: A Company determines the fixed dividend policy rate by apportioning the dividends on profits earned. This means that the firm pays out a fixed

amount of its profit after tax as dividends. Thus, the company maintains a fixed payout ratio of dividend. Payout is the ratio of dividends to earnings. A company may as a matter of policy, decide to constantly distribute 70 per cent of the after tax profit as dividends to its shareholders and reserve 30 per cent for retained earnings. Samuel and Inyada (2010) noted that this type of policy allows the shareholders the opportunity to clearly know the amount of dividend to expect from their investments in the company. However, the main criticism of this policy is that, since corporate annual profits are not fixed, adopting this policy may be traumatic to companies experiencing a volatile or fluctuating profit earning, and consequently, it may adversely affect the company's share prices. This is because the level of dividends is one of the benchmarks that measure the risks of a company.

Progressive dividend policy: Under this policy, a payment on dividend is on a steady increase usually in line with inflation. This could result in increasing dividend in money terms. The firm uses the policy as a ratchet (Samuel and Inyada, 2010). Every effort is made to sustain the increase even though marginal. Rarely, the company may be constrained to cut down on dividend payout; this is to enable it sustain its operations. This though is not a frequent option as it sends a wrong signal to investors. Firms operating this policy will opt to avoid paying dividends during the period rather than consistently cut down on the dividend (Kolb and Rodriguez, 1996).

Residual dividend policy: Dividends are just what is left over after the company determines the retained profits required for the future investment. This policy gives preference to its positive net present value (NPV) projects and paying out dividends if there are still left over funds available. Dividends become a circumstantial payment only paid when the investment policy is satisfied. There is a tendency therefore that this type of policy could give rise to a zero dividend structure. Firms may need to modify this policy to ensure that investors of different clienteles are not chased out by a strict application of the policy (Partington, 1985; Kolb and Rodriguez, 1996).

Low regular fixed policy with special or added dividend: Some companies follow a systematic low dividend with additional dividends when the company's profits are unstable and highly volatile. It is often difficult to maintain a regular high-level dividend distribution during unstable and high volatile earning. The company, therefore, seeks to pay consistent low

dividends and then pay other additional dividends in the years when it achieves high profits. Thus, the company is able to achieve consistency and continuity in the level of dividends, which is an indicator of greater importance on the part of investors who consider this necessary for building confidence with the company (Salih, 2010).

2.7.2. Factors Affecting Cash Dividend Policy

A multitude of factors affect the cash dividend policy of a company. The most important of these factors include legal, contractual, internal, growth and the expected expansion, shareholders' preferences for cash or capital gains, and capital market considerations. These factors are discussed in detail below:

Legal restrictions: Cash dividends should not exceed the total of retained earnings plus net profits for the current year. Ballantine and Hills (1935) refer to this as the Impairment of Capital Rule. Brealey *et al.* (2008) noted that companies are not free to declare whatever dividend they choose. For example, in some countries, such as Brazil and Chile, companies are obliged by law to pay out a minimum proportion of their earnings as dividends. Some restrictions may be imposed by lenders who are concerned that excessive dividend payments would not leave enough in the kitty to repay their loans. Some countries law helps to protect the company's creditors against excessive dividend payments. For example, in the United States, companies are not allowed by law to pay a dividend out of legal capital, which is generally defined as the par value of outstanding shares.⁷

Contractual Restrictions: Apart from legal requirements already mentioned, there are other contractual constraints affecting cash dividend policy. In order to ensure the protection of the rights of lenders, by reducing the risks of borrowing, companies usually enter into contracts with lenders (borrowing contracts) restricting the amount of profits a company should distribute as dividends to shareholders. Black and Box (1976) noted that when a company issues borrowing bonds, the contracts usually include permission and restrictions from the date of issuance of bonds till the repayment of the bonds. The bond contracts often will not allow the company to distribute cash dividends unless they exceed the

⁷ Where there is no par value, legal capital is defined as part or all of the receipts from the issue of shares. Companies with wasting assets, such as mining companies, are sometimes permitted to pay out legal capital.

amount earned in a certain amount. Similarly, the contract might also prevent the company from increasing the percentage distribution of normal profits or may determine the profits that could be distributed by the company for distribution. Finally, there are also restrictions on cash dividends imposed upon issuance of preference shares of the company. In this respect, it is natural to restrict the payment of dividends to ordinary shareholders until all the preference shareholders have been paid.

Internal constraints: Kato *et al.* (2002) noted that a company's ability to pay cash dividends is affected not only by profits and retained earnings, but also by the quantity of liquid funds available. Although a company can resort to borrowing in order to finance cash dividends or issue new shares to finance the dividend process, companies do not usually do so due to the high cost of these decisions. However, a company can use it in urgent cases to stabilize the level of dividends, since fluctuations in the value of dividends may convey a cost that could be higher than the distribution finance costs.

Company expected growth and expansions: The volume of capital expenditure required for financing expansion and growth significantly affects the cash dividend policy of a firm (Smith and Watts, 1992). If a company is in continuous expansion and development using modern technology, then it will need all the funds available to finance operations. In contrast, companies that have reached the stage of maturity are more inclined to distribute cash dividends than companies in growth.

Shareholders preference for cash dividends or capital gains: The focal point of financial management is to maximize the shareholders wealth. This suggests that shareholders' interest need to be taken into consideration when preparing the cash dividend policy. A company's ability to distribute cash dividends are often constrained by several important factors affecting the interest of the shareholders (see, Moyer *et al.*, 1995; Pike and Neale, 2009). These factors include the tax status of the shareholders, investment opportunities available for company owners, a stable and clear dividend policy, and profit information content. For example, if the company shareholders are affluent and are in high tax brackets, the company will resort to a dividend policy whereby it can reduce the impact of taxes on the shareholder's profits.

2.7.3 The Mechanics of Cash Dividend Payments

The announcement of dividends states that the payment will be made to all shareholders who are registered on a particular record date. When a dividend has been declared, it becomes a debt of the firm and cannot be rescinded. This is followed by the mailing of dividend cheques to shareholders after a week or so of the dividend announcements. Shares are normally bought or sold with dividend (or *cum dividend*) until two business days before the record date, and they trade *ex-dividend*. If an investor buy shares on the ex-dividend date, his purchase will not be entered on the company's books before the record date and would not have been entitled to the dividend. The chronology of a dividend payment involves the following four days, as discussed below.

Declaration date: Declaration date refers to the date on which the Board of Directors meets and declares the dividend. In their resolution, the Board will set the date of record, the date of the payment, and the amount of dividend for each class of share. When carried, this resolution makes the dividend a current liability for the firm.

On the declaration date- say on December 19- the directors meet and declare a regular dividend, issuing a statement similar to the following: "On December 19, 2012, the directors of Kennedy Corporation met and declared the regular yearly dividend of 50 kobo per share, payable to holders of record on December 19, payment to be made on January 9, 2013". For accounting purposes, the declared dividend becomes an actual liability on the declaration date. If a balance sheet is constructed, the amount (₦0.50) (times number of shares outstanding) would appear as a current liability and retained earnings would be reduced by a like amount.

Date of Record: This is the date on which the shareholders register is closed after trading day and all those who are listed will receive the dividend. At the close of business on the holder-of-record date, December 19, the company closes its stock transfer book and make up a list of shareholders as of that date. If Kennedy Corporation is notified of the sale before 5pm on December 19, then the new owner receives the dividend. However, if notification is received on or after December 20, the previous owner gets the dividend cheque.

Ex-dividend date: A share of stock goes *ex-dividend* at the date the seller is entitled to keep the dividend. Under the New York Stock Exchange (NYSE) rules for instance, shares are traded *ex-dividend* on and after the fourth business day before the record date. Because stock transactions must be settled by the fifth business day following the transaction, the major stock exchanges and securities dealers (in the over-the-counter market) establish an ex-dividend date four business days prior to the record date. On that date, the shares begin trading *ex-dividend*, that is, without dividend rights. Consequently, a stock normally opens for trading on the ex-dividend date at approximately the preceding day's closing price less the amount of the dividends per share (Emery and Finnerty, 1991).

In the above example, the ex-dividend date is four days prior to December 19, or December 15. Therefore, if buyer is to receive the dividend, he must buy the stock on or before December 14. If he buys it on December 15 or later, seller will receive the dividend because he will be the official holder of record. The dividends that accrue to the shareholder amount to ₦0.50. Barring any fluctuations in the stock market, one would expect the price of shares to drop by approximately the amount of dividend on the ex-dividend date. Thus, if Kennedy Corporation closed at ₦20 (0.5) on December 14, it would probably open at about ₦20 on December 15.

Payment date: Payment date is the date the dividend payment will be mailed to shareholders of record. In the above case, the company will actually mail the cheques to the holders of record on January 09.

2.8 Conclusion

This chapter examined the Nigerian economy and the structure of its financial system in order to provide the context for the investigation of the dividend question in Nigeria. The chapter observed that the Nigerian economy had been miraculously transformed from a miserable and unfriendly investment environment during the military rule to an investment 'haven' in Africa by the civilian administrations. The chapter also noted that these transformations were made possible due to various reforms pursued by the government. The chapter also provided a detailed discussion of the evolution, participants, liberalization, crash and performance of the Nigerian capital market from the period of the SAP in 1986 to

2012. In this context, the chapter noted the vital role played by the SEC towards re-engineering the capital market to restore confidence to the investing public after the global financial crisis which eroded investors' confidence.

In summary, since the return to democratic rule in Nigeria in 1999, there has been renewed commitment towards achieving a stable and conducive investment environment for both domestic and foreign investment. The civilian government has removed all antiquated regulations and military dictatorship decrees that had limited foreign investments, and this has led to influx of foreign direct investments into the country in recent years. The civilian administration has also embarked on the development of the non-oil export sub-sector to encourage the diversification of the economic base of the country away from oil.

CHAPTER THREE

LITERATURE REVIEW

3.1. Introduction

“Although a number of theories have been put forward in the literature to explain their pervasive presence, dividends remain one of the thorniest puzzles in corporate finance”

(Allen *et al.*, 2000, p.2499).

Although firms have been distributing dividends to their shareholders for more than five decades now, the motivation for this corporate policy has been a subject of considerable debate among financial analysts and academicians. The phrase the “dividend puzzle” was coined by Black (1976) to illustrate poor understanding of dividend payment policy. The author states that “the harder we look at the dividend picture, the more it seems like a puzzle, with pieces that just do not fit together” (p.5). In the course of attempting to solve this puzzle, the academic community have engaged in extensive theorizing and empirical research, but the dividend puzzle still remain unresolved as no single convincing explanation explains the observed dividend behaviour of firms (Brealey *et al.*, 2008). Thus, a lack of consensus exists on why firms pay dividends and the impact of dividend payment on the value of the firm.

From the angle of the dividend theories, two conflicting views exist. The first school of thought contends that a managed dividend policy is critical to the value of a firm (Graham and Dodd, 1934; Gordon, 1959, 1963; Lintner, 1962). The second school of thought argues that under a perfect capital market conditions, the dividend paid by a firm is irrelevant to the value of the firm (Miller and Modigliani, 1961; Black and Scholes, 1974; Miller and Scholes, 1982). This controversy between the two broad groups has stimulated a number of empirical investigations designed to establish management priorities and factors that underlie them. A number of investigations covering different countries have all reported management belief that dividend announcements communicate asymmetric information to the market about the future prospects of a firm. Studies in the USA by (Lintner, 1956; Baker *et al.*, 1985; Brav *et al.*, 2005), in the UK (Edwards and Mayer, 1985; Dhanani, 2005), and in Ireland (McCluskey *et al.*, 2007; Kester and Robins, 2011) all reached the same conclusion about the centrality of the relevance of dividend policy to firm value.

This chapter reviews the literature on the 'dividend puzzle' in order to provide the context for the investigation of the dividend policy and stock market reaction to dividend announcements in Nigeria. Given the focus on both the behavioural and empirical perspectives in this thesis, this chapter examines the behavioural theories that attempt to explain why firms pay dividends and reviews some of the prior empirical evidence that researchers have documented on these theories. The chapter divided the review into three major groups: The first part of the review focused on the main stylized facts about dividends and also examines the dividend theories and prior empirical studies conducted on these theories in the developed capital markets. The second part of the review discusses prior dividend policy research in emerging stock markets, including Nigeria, in order to provide a background against which the results of this thesis can be compared. The final part of the review provides a synopsis of the empirical literature on the semi-strong form of efficient market hypothesis in order to provide a backcloth against which the efficiency of the Nigerian stock market can be judged.

The remainder of this chapter is organized as follows: Section 3.2 reviews the classical theoretical perspective of dividend irrelevance in a perfect capital market setting. Section 3.3 examines the signalling hypothesis of dividend policy and also reviews the prior empirical studies on stock market reaction to dividend announcements in developed markets. Section 3.4 discusses the three other alternative explanations for paying dividends (agency, tax, and the bird-in-the-hand explanations) and also reviews the mainly developed capital market-based empirical evidence on these theories. Section 3.5 reviews the literature on managerial perspectives on dividend policy while section 3.6 examines the literature on industry influence on dividend policy. Section 3.7 reviews the extant literature on dividend policy and stock market reaction to dividend announcements in emerging markets. Section 3.8 gives a detailed review of the prior studies on dividend policy in Nigeria while Section 3.9 reviews the empirical studies that examined the semi-strong form market efficiency in both developed and emerging markets. Finally, Section 3.10 concludes the chapter by identifying the gaps in the dividend literature, which the current thesis seeks to fill.

3.2 Dividend Irrelevance Hypothesis

3.2.1 Theory

In 1961, the two future Nobel Prize winners, Merton Miller and Franco Modigliani published their seminal paper titled “Dividend Policy, Growth and the Valuation of Shares” in the *Journal of Business*. In this classic theoretical paper, Miller and Modigliani (1961) seriously challenged the general consensus that dividend policy does matter on the value of a firm. They demonstrated that under certain simplifying assumptions, a managed dividend policy is irrelevant. Instead, they argued that only the investment policy can affect firm value. This dividend irrelevance theorem is supported by researchers such as Black and Scholes (1974), Miller and Scholes (1982) and Bernstein (1996).

Miller and Modigliani (1961) further argued that investors can undo management’s decision on dividend policy by either reinvesting dividends or selling off stock (Miller and Modigliani, 1961). In other words, investors can create their own dividend position without any cost (homemade dividend) by selling part of their shareholdings in a firm equal to the value of cash profits that could have been distributed by the company or invest the dividend paid by the company if the investor shows no desire for cash dividend. For this reason, Miller and Modigliani (1961) concluded that shareholders would be indifferent between dividends and capital gains, and as a consequence, the value of a firm is independent of its dividend policy.

The dividend irrelevance theorem is based upon three basic assumptions: (1) perfect capital market, (2) rational behaviour, and (3) perfect certainty. The specific assumptions of the dividend irrelevance theorem can be summarised below:

- Information is costless and available to everyone equally;
- No distorting taxes exist;
- Floatation and transaction costs are non-existent;
- No contracting or agency costs exist;
- No investor or firm individually exerts enough power in the market to influence the price of a security;
- Investors are not systematically irrational;
- Investors have perfect access to capital;

3.2.2 Empirical Evidence

The dividend irrelevance hypothesis has been subject to empirical investigation. Black and Scholes (1974) constructed 25 portfolios of common stocks listed on the New York Stock Exchange (NYSE) to examine the relationship between dividend yield and stock returns. Consistent with the dividend irrelevance hypothesis, the authors reported that the dividend yield is not significantly different from zero, suggesting that neither high-yield nor low-yield payout policy of firms seemed to influence stock prices. Other studies such as Hess (1981), Miller and Scholes (1982), and Bernstein (1996) lent empirical support for the dividend irrelevance hypothesis.

Some empirical studies, however, provided evidence inconsistent with the dividend irrelevance hypothesis. For example, Ball *et al.* (1979) examined the relationship between dividends and firm value employing Australian data over the period 1960- 1969 and found no evidence in support of the dividend irrelevance hypothesis. Some researchers have also investigated the irrelevance hypothesis by surveying corporate managers involved in the determination of their firms' dividend policy (Baker *et al.*, 1985; Partington, 1985; Baker and Powell, 1999). These studies reported that corporate managers strongly believe that dividend policy is relevant to corporate value; contrary to the theoretical assumptions of the dividend irrelevance hypothesis. Overall, the empirical evidence on the dividend irrelevance hypothesis is mixed and inconclusive.

To sum up, the discussion in this section has been framed in the context of perfect capital markets and investor rationality. The crux of the Miller and Modigliani's (1961) dividend irrelevance argument is that investors can undo any dividend decision a firm's managers make by either selling off stocks or reinvesting dividends. If an investor desires to receive from a firm cash flow that exceeds the dividend payment chosen by the firm, the investor creates *homemade* dividends by selling stock to achieve the desired level. Alternatively, if the investor receives dividend cash flow that exceeds his or her consumption needs, the investor reverses the flow of unwanted dividends by purchasing additional stocks. However, in the real world, capital markets are less than perfect; information about the firm is not freely available to all market participants, conflicts of interest can occur among the firm's stakeholders, distorting taxes do exist, and investors may be systematically irrational. This

implies that in the absence of perfect capital market and investor rationality, there is possibility that a managed dividend policy may have an impact on shareholder wealth. The next two sections dwell on the challenges to the dividend irrelevance argument. It presents the theoretical the market frictions-related theoretical issues and available empirical evidence as they impact dividend policy.

3.3 Dividends and Asymmetric Information

One of the key assumptions of the dividend irrelevance hypothesis is that information about companies is available to all interested participants. However, an information asymmetry arises if one group has superior information about the current and future prospects of the firm. In the real world, managers are assumed to possess superior information about their firms relative to other market participants. This creates an imbalance between managers and shareholders conventionally known as 'informational asymmetry'. Myers and Majluf (1984) argued that information asymmetry between managers and outside investors may have implications for dividend policy since managers make their investment decisions by following a pecking order of financing choices.

The signalling hypothesis is based on market imperfection due to information asymmetry. This hypothesis suggests that in the presence of information asymmetry between managers and shareholders, managers pay dividends to signal to investors the state of affairs of the business, earnings growth and future prospects of the firm (Bhattacharya, 1979; John and Williams, 1985; Miller and Rock, 1985). Consequently, dividend increases (decreases) convey favourable (unfavourable) information about future cash flows of the firm. Therefore, the payment of dividends influences firm value because managers employ dividend policy as a 'costly-to-replicate' vehicle for conveying private information to market participants, causing stocks to sell at prices other than their true values.

3.3.1 Dividend Signalling Models

The central theme of all the dividend signalling models is that managers have private information about future prospects and choose dividend levels to signal that information. Bhattacharya (1979) developed a theoretical model of dividend signalling in which dividends

are seen as a costly means of removing information asymmetries in the market concerning a firm's true value. In Bhattacharya's model, corporate insiders can distribute cash to their shareholders in the form of dividends as a signal of expected future cash flows of a firm in an imperfect information setting. Specifically, the author asserts that if investors possess incomplete information about the future profitability of the firm and cash dividends are taxed at a higher rate than capital gains, the payment of dividends can communicate information to the market about future returns from current capital expenditure projects. In Bhattacharya's model, taxes are an important factor in determining dividend announcements' signalling effects. The author asserts that dividends are informative due to the higher tax rates on dividends relative to capital gains. Bhattacharya (1979) argues that when there are personal taxes on dividends, the level of the tax is positively related to the strength of the dividend signal. Specifically, the author asserts that the extra tax burden on dividend income is the major signalling cost because dividends are taxed at a higher rate than capital gains. Therefore, a taxable dividend is a good and credible signal, as it is costly for firms with poor performance to imitate. In a subsequent paper, Bhattacharya (1980) elaborated on a point made by Miller and Modigliani (1961) by analysing the dividend announcement as a non-dissipative signal to investors. The author noted that company management should refrain from using the dividend payment to manipulate market opinion because any such attempts would result to reduction in executive remuneration as a result of investors engaging in heavy net sales of securities of the company in question.

In John and Williams (1985) model, a signalling equilibrium with dividends is shown to exist without an asymmetric transaction cost. Their model is similar to Bhattacharya's with respect to the cost of signalling, as both models point to a tax penalty on dividends relative to capital gains as the primary cost of signalling. In this model, taxes are assessed on dividends but not on capital gains; and no transaction costs are incurred when issuing, retiring or trading shares. In this sense, dividends are dissipative. Nevertheless, corporate insiders distribute a taxable dividend in equilibrium and thereby reveal to outside investors the true present value of their firm's future cash inflows whenever either the firm or its shareholders sell shares in the capital market to raise cash. As a result, some firms optimally distribute dividends, while others do not. Also, some firms both distribute dividends and simultaneously sell new shares. These taxable dividends benefit current shareholders by

supporting their firm's stock price whenever either the firm or its stockholders sell shares to new investors.

Miller and Rock (1985) developed a dividend information model in which cash dividends operate as a signal of future operating cash flows of the firm. This version of the dividend signalling model impounded the expectations of outside investors about the operating cash flows of the firm and explained how a dividend decision is interpreted by the stock market on those grounds. The authors argued that if the amount of investment and external financing is fixed, the cash dividend paid by the firm provides investors with information concerning the firm's current and future operating cash flows. Miller and Rock's (1985) model partitioned the dividend announcement effect into two- the dividends surprise itself and an earnings persistence factor. In these circumstances management are tempted to pay out higher dividends than the market is expecting (thereby increasing the price of the company's shares) even if that means cutting back on investments. Therefore, the price of allowing for asymmetric information and the dividend announcement effects is the loss of optimal investments by the firm. The authors concluded that opportunity cost measured by productive investment forgone is the cost of maintaining the dividend signal.

In summary, the mitigation of the information asymmetry between managers and shareholders via unexpected changes in dividends is the cornerstone of the dividend signalling models (Frankfurter and Wood, 2002). The dividend signalling models argued that due to asymmetric information between managers and shareholders, dividends contain information about the current and future cash flows of the firm. As a result, managers have incentives to convey their private information to the market through dividend distributions in order to close the information gap. All the dividend signalling models argued that dividends are considered credible signalling device because of the dissipative costs involved. In the Bhattacharya's (1979) model, the cost of signalling is the transaction cost associated with external financing, whereas in Miller and Rock's (1985) model, the dissipative cost is the distortion in the optimal investment decision. On the other hand, in John and William's (1985) model, the dissipative cost of signalling is the tax penalty on dividends relative to capital gains.

3.3.2 Empirical Evidence

Extensive empirical research has been conducted on the several aspects of the use of dividends to signal firm insiders' private information to investors. Basically, these prior studies can be classified into two: (i) studies that test the information content of dividends; and (ii) studies that examined the interaction of dividend and earnings announcements.

3.3.2.1 Information Content of Dividend Announcements

The information content of dividend announcements has been widely addressed in the empirical literature, especially in countries with developed capital markets. The great majority of these studies have attempted to quantify how share prices respond to the announcement of changes in dividends in order to determine whether share prices move in the same direction with dividend change announcements. The objective has been to test the signalling hypothesis of dividend announcements. Majority of these studies generally reported that share prices follow the same directions as the dividend change announcements: dividend increases (decreases) are associated with significant increases (decreases) in share prices.

The earliest empirical study of the information content of dividend announcements is Petit (1972). The author examined the response of share prices to dividend announcements using 1,000 monthly and 135 daily dividend announcements of 625 firms quoted on the New York Stock Exchange (NYSE) over the period January 1964 to June 1968. The author reported that stock prices react significantly to dividend announcements, which suggests that dividends do contain information relevant to price formation. The author also documented that new information is fully reflected on the stock prices by the end of the month. Similar to Petit (1972), Laub (1976) and Petit (1976) also reported that dividends convey information about future earnings prospects beyond those predicted by past earnings. These findings are consistent with the signalling hypothesis of dividend announcements.

The publication of Petit (1972) study spawned many subsequent studies that have investigated the impact of dividend announcements on share prices from a variety of different perspectives and in a selection of different circumstances. For example, a number of studies have examined the stock market reaction to the announcement of changes in

regular dividends (Charest, 1978; Aharony and Swary, 1980; Eades, 1982; Woolridge, 1982; Divecha and Morse, 1983; Baraj and Vijh, 1995). These studies generally reported that share prices follow the same direction as the dividend change announcements. Charest (1978) examined the effects of dividend announcements of US firms over the period 1947-1968. Based on a sample of 177 dividend increases and 49 dividend decreases, the authors reported evidence of significant abnormal returns on the day of the announcement which were generally in same direction as the change in dividend (the average abnormal returns for the dividend increasing companies on the day of the announcement was 1.00% and for dividend decreasing companies was -3.18%). The author concluded that the evidence reveals information content in dividend announcements because abnormal returns are observed beyond the next quarter.

Aharony and Swary (1980) investigated the effects of dividend announcements which were made at different dates than earnings announcement, using a naïve dividend forecasting model. Similar to Petit (1972), the authors documented that cash dividend announcements do provide information beyond that provided by corresponding quarterly earnings announcements. The authors also provided evidence supporting the semi-strong form of the efficient market hypothesis. Other researchers such as Eades (1982) and Woolridge (1982), using dividend announcements made with no other corporate events, reported a positive association between dividend changes and abnormal returns.

Divecha and Morse (1983) examined returns surrounding the announcement day performance of US firms that increased their dividends. The authors examined this using a sample consisting of all non-regulated and non-bank firms on the NYSE for the period May 1977 to February 1979. Dividend increases were found to be associated with an average abnormal return of 0.84% on the day of announcement. Moreover, the abnormal returns observed during this period were directly related to the proportional change in the dividend. Baraj and Vijh (1995) examined the price formation process during dividend announcements. Using daily closing prices as well as transactions data, they found that the average excess returns for all dividend announcements increases as the firm size and stock price decrease. Similar to Petit (1972), all these studies reported evidence that dividends convey information about future earnings to the market, which is consistent with the dividend signalling models.

In contrast, there are a number of studies which fails to find support that dividend changes convey information about future earnings. For example, Watts (1973), Gonedes (1978), and Bernatzi *et al.* (1997) indicated that dividends are not good predictors of a firm's future earnings. The results from these studies indicated that although positive relationship exists between dividend changes and future earnings, it was relatively weak. Watts (1973) examined the relationship between unexpected dividend changes and positive future earning changes and subsequent excessive stock returns, using earnings, dividend and share returns data for a sample of 310 US companies during the period 1946 to 1967. Watts (1973) concluded that dividends have trivial information content about future earnings. In other words, the author asserts that the relationship between current dividends and future earnings was, on average, positive but relatively weak. His analysis suggests that dividend convey little if any information about stock valuations, once current earnings are controlled for in the experiment. Gonedes (1978) produced similar results. In particular, Gonedes (1978) reported evidence that was uniformly inconsistent with the view that annual dividend signal reflect information beyond that reflected in contemporaneous annual income signals. As a result, Gonedes (1978) rejected the information content of dividend hypothesis. Bernatzi *et al.* (1997) examined the relationship between firms' future earnings and dividend changes. Based on a sample of 1,025 NYSE and AMEX firms who made at least two dividend announcements in the period 1979-1991 which generated 7,186 announcements of dividend changes, the authors examined whether changes in dividends have information content about future earning changes. Consistent with Watts (1973), the authors were unable to find any evidence to support the view that changes in dividends have information content about future earning changes. The authors noted that:

“...there is a strong past and concurrent link between earnings and dividend changes; the predictive value of changes in dividends seems minimal. Indeed, the only strong predictive power we can find is that dividend cuts reliably signal an increase in future earnings”

(Bernatzi *et al.*, 1997, p.1031)

Other studies have examined the market response to the announcement of major changes in a firm's dividend policy such as a dividend initiation and/or omission. The findings of these studies are consistent with the proposition that changes in existing dividend levels are

both preceded and followed by distinctive earning patterns. Asquith and Mullins (1983) investigated the impact of dividend announcement on share prices of firms that initiated dividends for the first time, using a naïve dividend forecasting model. In particular, the authors re-examined the stock price reaction to dividend announcements using daily stock price data to control for other contemporaneous information announcements. The authors investigated the impact of initial dividend payments and the initiation of dividends after a 10-year hiatus, and reported significant positive abnormal returns at dividend initiation announcements. Similarly, Richardson *et al.* (1986) examined impact of dividend changes on the share values using a sample of 192 U.S. firms that initiated dividends for the first time during the period 1969 through 1982 and reported results similar to those documented by Asquith and Mullins (1983).

Benesh *et al.* (1984) examined the market reaction to substantial shifts in dividend policy. Specifically, the authors investigated the aggregate market response to (1) omitted dividends, (2) dividend decreases of at least 25%, (3) dividends increases of at least 25%, and, (4) initial dividend payment. Their results indicated that announcements of dividends do convey information to the market. The authors asserted that initial dividends are generally unexpected and therefore convey much more relevant information than other potentially favourable announcements. Their results are consistent with the dividend signalling hypothesis. Similarly, Healy and Palepu (1988) examined the market response to dividend initiation and/or omission of US firms from 1969 to 1980. The authors noted that earnings change significantly around a dividend initiation and omission. Specifically, the authors observed that most of the dividend-initiating firms in their sample of 131 observations experienced earnings growth for at least one year prior to the dividend announcement; this growth continued throughout the year of the dividend initiation and went on for two subsequent years. In contrast, for the 172 firms in their sample that omitted their dividend, the authors noted a significant decline in earnings two years before the omission and also in the year of omission, but this decline was reversed in subsequent years. These findings suggest that the information transmitted by dividend initiations and dividend omissions is associated with the earnings changes following the announcement of the dividend changes. These results are in line with those reported by Fama and Fabiak

(1968) and Watts (1973) that show dividend initiations and omissions can, in part, be predicted by changes in past and current earnings.

Gosh and Woolridge (1991) studied successive dividend omissions by NYSE companies in the period 1962 to 1984. Based on a sample of 358 first omissions, 160 second omissions, 72 third omissions, 29 fourth omissions, and 55 fifth or higher omissions, the authors reported that management appeared to use dividend omissions to convey negative news and that in most cases dividend omissions are followed by lower earnings announcements or trading losses. Moreover, it appeared that an initial dividend omission announcement is typically associated with a large share price loss, but subsequent omission announcements are not.

Michaeli *et al.* (1995) examined abnormal returns after dividend initiations and omissions using a firm size based expected returns model. Based on a sample of NYSE and AMEX companies that initiated or omitted dividends in the 25-year period from 1964 to 1988, the authors computed excess returns for the year before the initiation (omission) and during the three-day window around the dividend initiation event (the day before the event and the day after the event). The authors documented that the short-term price impact of a dividend omission was negative and that of dividend initiation was positive. In particular, the authors observed that the average performance of portfolios for the 561 firms that initiated dividend was significantly better than the benchmark portfolios (non-initiation firms) experiencing an excess return of +15.1% in the year before the dividend initiation. During the three-day announcement (event) period dividend initiation portfolios experienced a significant additional excess return of +3.4%. However, for the 887 firms in their sample that omitted dividends, the authors observed a significant decline in excess returns for the year before the omission and during the three-day window around that event. The authors concluded that average short-term performance of portfolios that initiated dividends in that period was significantly better than benchmark portfolios while the average short-term performance of portfolios that omitted dividends in the period was significantly worse than the benchmark portfolios.

Kaestner and Liu (1998) provided a more comprehensive empirical analysis on the relationship between dividend announcements and stock price reactions. Using two types of announcements: dividend initiations and specially designated dividends, the authors tested

several competing theories regarding the information content of dividend announcements. The results of their analysis provided strong support for the single signal, cash-flow signalling hypothesis, and only weak support for the multiple signal cash-flow signalling models. The authors also found that the size of dividend payment was the most significant and most consistent predictor of the variation in stock price responses to dividend announcements. In a similar vein, Patricia *et al.* (2000) provided recent evidence on the information content of dividend announcements using data from NASDAQ firms that initiated or omitted dividends. In particular, the authors examined the rationales behind dividend initiation or omission. Using cross-sectional weighted least squares regression, the authors' documented strong support for the dividend-signalling hypothesis and weak support for the free cash flow hypothesis in explaining the share price reactions to dividend announcements. However, when the authors controlled for fluctuations in individual risk around the dividend announcement date, they found significant wealth and variance effects upon the initiation or omission of dividends.

3.3.2.2 Interaction Effect of Dividend and Earnings Announcements

Despite the significant number of studies that documented evidence that dividends contain information relevant to price formation, there is still considerable controversy about whether abnormal reaction in share prices can be attributed to dividend announcement alone. Researchers have uncovered the fact that dividend news is not disclosed in isolation, but is instead published at the same time as other data such as earnings data, earnings forecast, and capital expenditure announcements. As a result, when dividends and earnings announcements occur simultaneously, the unexpected effects on share prices may not be solely attributable to the dividend announcements alone. Kane *et al.* (1984) observed that when the dividend announcement occurs at the same time as other disclosures, the effect of other announcement has been treated as "a statistical nuisance that muddies the water and introduces methodological complications" (Kane *et al.*, 1984, p. 1091). The authors, therefore, suggested that dividend and earnings announcement should be evaluated in relation to each other to see if there is an interaction effect.

The impact of complex signals on share values has been examined in a number of US based studies and a new strand of the signalling literature-based upon *interactive signals*- has

rapidly developed. Kane *et al.* (1984) examined the corroboration effect between dividend and earnings announcements, using 352 observations of US manufacturing firms that made quarterly dividend and earnings announcements which occurred within 10 days of one another between the fourth quarter of 1979 and the second quarter of 1983. Their results indicated that unexpected earnings and dividend announcements appeared to induce abnormal returns and when dividends and earnings were both increased, the stock market reaction was more favourable than only when one variable increased in isolation, although the dividend signal appeared to dominate. The authors also reported that dividends and earnings announcements are indeed interpreted in relation to each other, and that the interaction or corroborative effect was statistically significant. A study by Eddy and Seifet (1992) which also examined the US stock market's reaction to contemporaneous dividend and earnings announcements arrived at the same conclusion. The authors found that when dividends and earnings were made jointly, the share price reaction was significantly greater when the signals supported each other than the reaction to a single announcement.

Examination of the impact of complex signals on share values has also been extended to countries outside the US. For example, Liljebloom (1989) examined the effect of the announcement of stock dividends and stock splits in the Stockholm Stock Exchange. He documented a corroboration effect between earnings and dividend announcements. In a similar vein, Easton (1991) investigated the interaction effect between contemporaneous announcements of dividends and earnings on stock prices using Australian data. The author's sample was drawn from 339 Australian industrial firms that were quoted on the Melbourne Stock Exchange that declared half yearly dividends and earnings announcements that occurred simultaneously between December 1975 and December 1981. Using the same interaction model specified by Kane *et al.* (1984), the author provided evidence of a corroboration effect between earnings and dividend announcements, indicating that investors are influenced by the interplay of signals in reaching their buying and selling decisions. This result is consistent with the information content of dividend hypothesis.

Lonie *et al.* (1996) examined the capital market reactions to a variety of simultaneous dividend and earnings announcements by UK companies over a six-month period January to June 1991, using the same interaction model specified by Kane *et al.* (1984). The authors' purpose was to investigate whether UK dividend announcements contain information which

is additional to, or confirmatory of, earnings information, especially when the earnings information contains an element of “surprise” for investors. They found that the dividend-increasing companies on average earned a positive abnormal return of 2.03 per cent whereas the dividend-decreasing companies on average earned a negative abnormal return of 2.35 per cent during the dividend announcement period. In terms of the interaction effect between dividend and earnings, the authors reported that the empirical results of the interaction effects were significant; indicating that both signals jointly influenced the level of abnormal returns on stock prices. The authors also noted that the market response was strongest when the dividends and earnings signal corroborate one another, but that earnings signal had greater impact on stock prices than dividends.

Abeyratna and Power (2002) revisited the dividend-signalling hypothesis by examining the post-announcement performance of UK companies which disclosed dividends and earnings news to the capital market on the same day during the five-year period from 1989 to 1993. The authors found that the outstanding performance demonstrated by *good-news* companies in the dividend-increase earning-increase (DIEI) sample before the increase in their dividend and earnings did not persist beyond the announcement period. On the other hand, the authors reported that the *bad-news* companies in the dividend-decrease earning-decrease (DDED) sample outperformed their *good-news* counterparts in terms of growth in financial profiles. The authors concluded by questioning the validity of the dividend-signalling hypothesis, since the results from the study suggested that a reduction in dividend is evidence of a firm adapting its corporate finance policies to turn their performance around, rather than the notion that dividend cuts convey negative signals about the future performance of the firm.

Using data from Ireland, McCluskey *et al.* (2006) examined stock market reaction to concurrent dividend and earnings announcements in an environment in which most of the stocks are thinly-traded, but disclosure of information is as sophisticated as that which exists on larger markets. They used a sample of 50 companies that made 674 dividend announcements to Irish investors over a 15-year time span. The authors reported evidence of a statistically significant market reaction on the dividend announcement day. The authors also found evidence of an interaction effect between dividend and earnings announcements, although their analysis suggests that earnings component dominates, with

the role of dividends limited to its interaction with earnings news. The authors concluded that the joint signalling effect of dividends and earnings in developed capital markets is not restricted to the largest, most liquid exchanges nor is dependent on the existence of 'typical' macroeconomic conditions.

3.4 Dividends and Other Related Models

The Miller and Modigliani's (1961) argument that the dividend policy adopted by a firm is irrelevant to its market value is based on the assumption of perfect capital markets and investor rationality. However, the real business world is characterised by information asymmetry, agency costs, distorting taxes, and irrational investor behaviour. Consequently, in the absence of perfect capital market and investor rationality, academics believe that a managed dividend policy have an impact on shareholders' wealth. The preceding section described how dividends can be used by managers to signal to investors the firm's future prospects and also discussed prior studies that examined the implication of the signalling hypothesis. In current section, the other three alternative explanations for paying dividends and their prior empirical evidence are discussed.

3.4.1. Dividends and Agency Problems

One of the assumptions of the Miller and Modigliani (1961) dividend irrelevance literature is that the firm's operating, investment, and other financial decisions are independent of the firm's dividend policy. This assumption suggests that when dividends are paid, the equity of the firm is maintained at its target level by the issuance of additional shares of common stock. In reality, however, firms rarely sell equity to counterbalance dividend payments and maintain a constant capital structure. Therefore, in contrast to the assumption of the dividend irrelevance hypothesis, dividend policy can affect asset composition, capital structure, investment plans, and consequently firm value. This sub-section considers how dividend payments affect the assets of the firm, security values, and the contractual arrangements among the various stakeholders of a firm.

3.4.1.1 Agency Theory

An important explanation of why firms pay dividends is the existence of agency costs, which stems from agency conflicts due to separation of ownership and control between various stakeholders of the firm. Agency conflicts arise in firms because corporate decisions are made by managers (agents) on behalf of the firm's owners (principals). The first conflict of interests that could affect dividend policy is between shareholders (principals) and managers (agents). The separation of ownership and control may result in conflicts of interests between managers and shareholders because management may not always act in the best interests of the firm owners (Donaldson, 1963; Jensen and Meckling, 1976). In this context, Jensen (1986) argued that managers motivated by compensation and human capital considerations have incentives to overinvest free cash flows even in the absence of profitable investment opportunities (free cash flow hypothesis). For instance, managers may invest in unprofitable investments such as lavishing resources on corporate jets and hunting trips as well as by investing in unjustifiable acquisitions and expansions. This problem induces shareholders to incur agency costs to monitor managers' behaviour. The costs associated with this potential conflict of interests include expenditures for structuring, monitoring and bonding contracts between shareholders and managers, and the residual losses due to imperfectly constructed contracts (Jensen and Meckling, 1976).⁸

The second conflict of interest that could affect dividend policy is between shareholders and bondholders. In this case, shareholders are considered as the agents of the debt holders funds (Al-Malkawi *et al.*, 2010). Debt holders are entitled to receive interest payments periodically and to receive the face value of their principal upon the debts maturity (Lease *et al.*, 2000). However, equity holders may try to expropriate wealth from debt holders (Jensen and Meckling, 1976; Myers, 1977). This wealth expropriation could come in the form of excessive dividend payments, either by reducing investments by the shareholders in order to increase dividends (investment-financed dividends) or by raising debt to finance the dividends by the shareholders (debt-financed dividends). In both cases, if the increase in

⁸ Monitoring expenditures are paid by the principal to regulate the agent's conduct, while bonding expenditures are made by the agent to help assure that the agents will not take actions which damage the principal or indemnify the principal if the prescribed actions are taken. The residual loss is the value of the loss by the principal from decisions by the agent which deviate from the decisions the principal would have made if he had the same information and knowledge as the agent.

dividends is unanticipated by debt holders, then the market value of debt will depreciate and the market value of equity will appreciate. As a result, bondholders prefer to put constraints on dividend payments to secure their claims while shareholders prefer to have large dividend payments (Ang, 1987).

The minimization of the costs associated with the separation of corporate ownership and control is the cornerstone of modern agency theory. Jensen and Meckling (1976) noted that agency costs could be alleviated by increasing managers' equity ownership in the firm which would better align managers' interests with the interests of the shareholders, while Barnea *et al.* (1981) argue that agency problems could be minimized through the use of complex contractual arrangements between management and shareholders. The mitigation of potential shareholder and bondholder conflicts through debt covenants are necessary to prevent bondholder wealth transfers to shareholders (John and Kalay, 1982). However, these remedies create substantial costs to the shareholders. Dividend policy plays a significant role in controlling agency problems. Dividend policy plays an important role in mitigating the potential manager and shareholder conflicts. Large dividend payments reduce the discretionary funds available for perquisite consumption and require managers to seek financing in capital markets. The efficient capital market monitoring of the activities of the firm reduces less than optimal investment activity and excessive perquisite consumption and hence reduces the agency costs associated with the separation of ownership and control (Easterbrook, 1984).

Furthermore, increase in dividends will help reduce the overinvestment problem by reducing the free cash flow under management discretion which might otherwise have been wasted in non-value maximizing project and thus increase the market value of the firm. This is because the less discretionary cash that management has, the harder it is for them to invest in negative NPV projects (Allen and Michaely, 2002). To the extent that shareholders are rewarded by cash dividends and capital expenditures are financed by the new issue of shares or by debt, the company dividend policy acts as a monitoring device which reduces the agency conflict between managers and the shareholders of the firm thereby diminishing the agency cost of equity (Grossman and Hart; 1980; Jensen, 1986). In a similar vein, a higher dividends payout helps control the impact of widespread ownership (Rozeff, 1982). Manos (2002) noted that the more dispersed the ownership structure, the more acute the

free rider problem and the greater the need for outside monitoring. The payment of dividends therefore acts as a monitoring device, like a bonding cost or an auditing cost which mitigates the deadweight costs of agency conflicts between managers and shareholders thereby diminishing the agency cost and thus enhances shareholder value.

In summary, the core of the agency problem as discussed by Jensen (1986) is the inability of dispersed shareholders to prevent corporate management from expropriating their wealth due to conflicts of interests, diversification of risk and different time horizons. Since it is harder for management to renege on a debt commitment relative to a dividend commitment, then a more effective mechanism to impose discipline is to increase the level of debt (Grossman and Hart, 1980; Jensen, 1986). The payment of dividends is one way to reduce this conflict because high payouts to shareholders limit flexibility and inefficient managerial investments. Dividends therefore represent an effective mechanism for monitoring managers' potential to misuse excess funds. Thus, high dividend payouts help to resolve agency problems and thereby increase firm value to its shareholders.

3.4.1.2 Empirical Evidence

The agency costs explanation for dividend relevance has been extensively addressed in the empirical literature. Rozeff (1982) was the first to establish an empirical relationship between agency costs and dividend policy. The author employed a sample of 1,000 non-regulated firms in 64 different industries from 1974 to 1980. The author used two variables as proxies for agency costs and finds that these variables are important determinants of dividend policy. Specifically, the author documented that firms establish higher dividend payouts when insiders hold a lower fraction of the equity and/or greater number of shareholders owns the outside equity. This evidence lend credence to the view that dividend payments is part of the firm's optimum monitoring/bonding package and serve to reduce agency costs.

Crutchley and Hansen (1986) examined the relationship between ownership, dividend policy and leverage using a sample of industrial firms for the period 1981 to 1985 and reported that managers make financial decisions to efficiently control agency costs. Specifically, the authors reported that increased earnings volatility impacted both managerial ownership

and dividends positively. Similarly, Jensen *et al.* (1992) investigated the determinants of cross-sectional differences in insider ownership, debt and dividend policy using a common empirical framework. Specifically, the authors employed three-stage least squares for a sample of 565 firms for the year 1982 and 632 firms for the year 1987. They documented that insider ownership is one of the most influential determinants of dividend policy. They concluded that management prefers not to declare more dividends when the major shares of the company is owned by insiders but rather increases directors fees and so on. This evidence is consistent with the agency cost hypothesis by Rozeff (1982), and suggested that the benefits of dividends in reducing agency costs are smaller for companies with lower dispersion of ownership and/or higher insider ownership.

Holders *et al.* (1998) provided further empirical support for the agency explanation for paying dividends. The authors examined the relationship between dividend policy and investment decisions of 477 NYSE listed companies over the period 1980 to 1990. They found a strong influence of agency costs on dividend policy decision of the sample companies. In particular, they authors reported a significant negative association between insider ownership and dividend payouts and a significant positive association between number of shareholders and dividend payout. In a similar vein, Saxena (1999) investigated the determinants of dividend policy of 235 unregulated and 98 regulated NYSE listed firms over the period 1981 to 1990. Consistent with Holders *et al.* (1998) and Rozeff (1982), the author documented that agency costs affects dividend policy. Similarly, Moh'd *et al.* (1995) examined agency theory across different firms and through time employing data from the annual financial statements for 341 US firms for the period 1972 to 1989. The authors reported that dividend policy appeared to be a function of firm size, growth rates, operating/financial leverage, intrinsic business risk, and ownership structure; the findings also indicated that managers of sample firms seem to minimise agency cost and transaction cost in a manner consistent with the existence of an optimal dividend payout ratio. The authors concluded that 'firms adjust their dividend payout in response to dynamic shifts in the agency cost/transaction cost structure as changes are observed to occur' (Moh'd *et al.*, 1995, p.383).

Another strand of the empirical test of the agency conflicts between managers and shareholders have examined the free cash flow hypothesis. The free cash flow hypothesis

suggest that increase in dividend payments reduce the cash flow that would have been otherwise invested in negative NPV projects. Lang and Litzenberger (1989) examined the free cash flow hypothesis employing the framework of the principal-agent conflict developed by Berle and Means (1932) and extended by Jensen (1986), and found that cash flow has strong explanatory power; this evidence is consistent with the free cash flow hypothesis. In contrast, Denis *et al.* (1994) examined the relationship between dividend yield and Tobin's Q on a sample of 5,992 dividend increases and 785 dividend decreases over the period 1962 to 1988. The authors reported evidence inconsistent with the free cash flow hypothesis. Other researchers such as Howe *et al.* (1992) and Yoon and Starks (1995) also reported evidence that challenge the findings of Lang and Litzenberger (1989) in that they found no relationship between Tobin Q and stocks reaction to dividend announcements. Recently, Lie (2000) examined the free cash flow hypothesis using a large sample of special dividends, regular dividend, and self-tender offers. He reported evidence inconsistent with the free cash flow hypothesis.

However, empirical evidence from more than 4000 companies from 33 countries around the world including some emerging markets indicates that firms pay more dividends in countries where shareholders have better protection, suggesting support for the agency cost explanation for paying dividends (La Porta *et al.*, 2000). In a similar vein, Grullon *et al.* (2003) found evidence consistent with the free cash flow hypothesis. The authors reported a declining return on assets, cash levels, and capital expenditure in the years after dividend increases. This finding suggests that firms that expect a reduction in their investment opportunity set are the ones that are more likely to increase dividends. In general, empirical evidence on the free cash flow hypothesis of the agency costs explanation for paying dividends is at best mixed.

To sum up, the agency theory of dividend policy is primarily based on the argument that there is conflict of interests between various stakeholders of the firm, especially between managers and shareholders. Specifically, managers may deviate from acting in the shareholders' best interests to allocate the firm's resources to benefit themselves. For example, managers may lavish the firm's resources on luxurious offices and unjustifiable mergers and acquisitions. Therefore, excess cash can create overinvestment problem because they may be used to fund negative NPV projects. To mitigate the overinvestment

problem, agency theory suggests that firms return excess cash to shareholders by paying dividends (Easterbrook, 1984; Jensen, 1986).

3.4.2 Dividends and Taxes

A key assumption of the Miller and Modigliani's (1961) dividend irrelevance hypothesis is that no distorting taxes exist. In the real world, however, distorting taxes do exist. Financial economists have theorized that taxes might have important effects on corporate dividends decisions. Therefore, in the presence of taxation, the argument for dividend irrelevance seems unrealistic. This sub-section presents the tax-related theoretical argument for dividend relevance and available empirical evidence on the tax effect hypothesis.

3.4.2.1 Tax Preference/Clientele Effect Theory

Another important explanation for dividend relevance is based on the taxation of dividends. Under the assumptions of a perfect capital market without taxation or transaction costs, Miller and Modigliani (1961) demonstrated that the dividend paid by a firm does not influence its market value since it will be matched with an equivalent capital loss. One of the implications of the dividend irrelevance hypothesis is that no distorting taxes exist. However, in the real business world, taxes exist and may have significant influence on dividend policy and the value of the firm. Furthermore, there is often a differential tax treatment of personal income from dividends and capital gains in most countries, such as the US. Thus, the influence of taxes may affect the demand of dividends because most investors are interested in *after-tax* return. Similarly, taxes may also affect the supply of dividends when managers are seeking to maximize shareholder wealth by increasing the retention ratio of earnings (Lease *et al.*, 2000; Al-Malkawi *et al.*, 2010).

Taxation is therefore an important cost associated with dividend payments. Dividend policy is affected by three tax rates: (a) corporation tax (b) dividend income tax and (c) capital gains tax. Evidence from literature suggests that investors' preference or aversion to any dividend policy depends on the relationship among the three tax rates (Dimitrios and Dimitrios, 2007). According to the tax preference theory, investors select firms whose dividend policies suit their tax preferences (Elton and Gruber, 1970; Miller, 1977; Miller and Scholes, 1978). This implies that the taxation of dividends and capital gains on shares is

likely to influence the preference for receiving cash either in the form of dividends or capital gains. For example, investors prefer cash dividends to capital gains when the dividend tax rate is smaller than capital gains tax rate. In contrast, investors prefer “home-made” dividends (generated through liquidating part of their shareholding) to cash dividends when the rate of capital gains tax in some countries is lower than the top income tax rate. Thus, a low dividend payout ratio lowers the cost of capital and increases the stock price.

On the other hand, the clientele-effect of dividends hypothesis suggests that pre-existing dividend clientele might play a role in dividend policy. Dividends can therefore be used to influence the class of shareholders attracted to a particular firm. Miller and Modigliani (1961) noted that market imperfections such as transaction costs and differential tax rates might influence investors to choose securities that reduce these costs. As a result, taxes and transaction costs may create investor clienteles such as tax minimisation clientele, for example, institutional investors. Given this favourable tax treatment, clienteles such as institutional investors tend to be attracted to invest in dividend-paying shares (Allen *et al.*, 2000). Institutional investors are also often subject to restrictions in institutional charters (such as the “prudent man rule”) which prevent them from investing in non-paying or low-dividend stocks. This Legal restriction makes dividends appealing to institutional investors (Brav and Heaton, 1997). This clientele will increase the value of the firm to all shareholders, since it monitors the management and thereby increases the firm’s value.

In summary, taxation is one of the critical factors that affect firm value and future expected profits. The central theme of the tax/clientele effects of dividends hypothesis is that dividends are taxed at a higher rate than capital gains, and as a result shareholders prefer a dividend pattern that matches their desired consumption pattern. The tax-effect hypothesis is based on the proposition that dividends are taxed at a higher rate than capital gains. As a result, taxable investors will demand superior pre-tax returns from stocks that pay a large proportion of their income in the form of highly taxed dividends. In contrast, the tax-clientele hypothesis suggests that clienteles such as institutional investors tend to be attracted to invest in dividend-paying stocks because they have relative tax advantages over individual investors (Allen *et al.*, 2000; Al-Malkawi *et al.*, 2010).

3.4.2.2 Empirical Evidence

The empirical work on the tax argument focuses on two main issues: the tax-effect and the clientele-effect. The tax-effect hypothesis is often studied by employing the Brennan's (1970) model, which involves examining the relationship between dividend yields and stock returns (Black and Scholes, 1974; Litzenberger and Ramaswamy, 1979; Miller and Scholes, 1982; Porteba and Summers, 1984; Michaely, 1991; Kalay and Michaely, 2000). For example, Black and Scholes (1974) tested the Brennan's model by examining the relationship between dividend yield and stock price under the existence of a tax differential between dividends and long-term capital gains, using monthly data on dividends, prices and returns for every firm listed on the NYSE from 1926 to 1966. The authors introduced a dividend yield variable into a CAPM-based model and noted that the dividend yield variable was significantly different from zero. The authors concluded that low or high-dividend yield stocks do not affect the returns of stocks either before or after taxes; this evidence is inconsistent with the tax effect hypothesis. In a similar vein, Michaely (1991) took advantage of the introduction of the 1986 Tax Reform Act in the U.S. which reduced the difference between the tax treatment of realised long-term capital gains and dividend income to examine the effect of taxation changes on ex-dividend day price. The author analysed the behaviour of stock prices around ex-dividend days during the period 1986-1989, and reported no evidence of a negative tax effect either before or after the TRA. Michaely (1991, p.857) concluded that "a change in the individual investor's tax rates has no significant effect on ex-dividend day prices". The author's evidence suggested that it was mainly short-term and corporate traders who favour dividend income over capital gains sufficiently to influence the ex-dividend price.

In contrast, Litzenberger and Ramaswamy (1979) extended the Brennan's model and classified stock into yield classes using a monthly dividend yield definition. The authors found evidence of a tax effect. In particular, the results of their study show that the coefficient on the dividend yield variable is positive and highly significant. Miller and Scholes (1982) challenged Litzenberger and Ramaswamy's results and argued that the positive yield coefficient was driven by information bias. To determine whether the positive dividend yield is due to information effects, Black and Scholes attempted to correct for information bias and tested the tax-effect using the same sample employed by Litzenberger and

Ramaswamy. The authors found that the dividend yield coefficient was not statistically different from zero. However, Kalay and Michaely (2000) carried out a similar test, excluding all weeks containing dividend omissions and found a positive and significant dividend yield coefficient; this result is inconsistent with the findings of Miller and Scholes (1982). In general, empirical support for the tax-effect hypothesis is at best mixed and inconclusive.

Further evidence in support of the tax effect hypothesis was provided by Callaghan and Barry (2003) who examined ex-dividend day trading of American Depositary Receipts using a sample of 1,043 dividends over the period 1988 to 1995. The authors reported evidence that is consistent with tax-motivated trading. In a similar vein, Elton *et al.* (2005) investigated the ex-day pricing under different tax regimes of two mutual funds for over the period 1988 to 2001. Their data was unique because it contains a set of securities (municipal bond funds) for which the ex-dividend price drop should be greater than the dividend if taxes matter as well as a set of securities (taxable bond) for which the drop should be in general less than the dividend. For the non-taxable municipal bond funds, the authors documented that stock prices drop by more than the amounts of dividends on the ex-day. In the case of the taxable bonds, the authors reported evidence that drop in price for the ex-day is smaller than the amount of dividends when dividends are taxed higher than capital gains. For the case where dividends and capital gains are taxed at the same rate, the authors found that stock prices fall by the exact amount of the dividend. Their findings are consistent with the hypothesis that taxes determine the value of dividends relative to capital gains.

On the other hand, researchers have taken different paths in the examination of the clientele-effect hypothesis. One strand of empirical testing has examined investors' portfolios and their demographic attributes including taxes (Al-Malkawi *et al.*, 2010). Petit (1977) and Scholz (1992) examined the portfolio positions of individual investors, and reported evidence consistent with dividend/tax-clientele hypothesis. In particular, Petit (1977) reported a positive relationship between investors' ages and their portfolios' dividend yield. The authors also found a negative relationship between investors' income and dividend yield. In a similar vein, Scholz (1992) found that differential tax treatment of dividends and capital gains influences investors' decisions in choosing between higher-or-lower-dividend yield portfolios. However, Lewellen *et al.* (1978) found only very weak

evidence in support of the clientele effect hypothesis using a sample constructed from same database used in Petit's (1977).

Another strand of empirical tests of the clientele effect hypothesis has examined the tax characteristics of marginal investors by studying the movement of stock prices around the ex-dividend days. One of the earliest studies on ex-dividend day pricing was published by Campbell and Beranek (1955). The authors documented that ex-dividend behaviour of stock prices has an impact on the portfolio decisions of investors. The authors reported evidence that on average, ex-day stock prices drop by less than the amount of dividends. Elton and Gruber (1970) provided a more detailed empirical investigation of the clientele effect hypothesis when they tested a method of determining marginal stockholder tax brackets and its implications on corporate investment policy, dividend policy, and the assumption of market rationality. Using a US data for the period April 1966 to March 1967, the authors documented evidence of a statistical relationship between the dividend policy of firms and the tax brackets of their shareholders. In particular, the authors reported that shareholders with higher income tax brackets were associated with low dividend shares and those with lower income tax brackets were associated with high dividend shares. This evidence lend credence to the tax-induced clientele effect hypothesis which states that investors in high tax brackets favour capital gains over dividend policy.

Recently, Li (2005) examined whether institutions and individuals react to ex-dividend events and how their reactions impact ex-day excess returns. The authors reported that both type of investors' trade around the ex-day to release their tax burdens. This result is consistent with the notion that the differential taxation of dividends and capital gains influence the ex-day price behaviour. Brown and Zhang (2006) provided further evidence in support of the tax hypothesis. The authors examined the impact of the 2003 dividend tax cut in the United States which removes the preferential tax treatment of capital gains over dividends. Consistent with the tax hypothesis, the authors found that the ratio of the change in price over the dividend on the ex-day increases from 0.749 in 2002 to 0.946 in 2004, which is close to one as predicted by Elton and Guber (1970) when there is no differential taxation between dividends and capital gains. The authors also reported that the average ex-day abnormal return of taxable distributions decreases after the tax cut. More recently, Hassett and Auerbach (2006) examined the impact of the dividend income Tax

Relief Act of 2003 in the USA. The study documented that the tax cut had significant impact on the equity market such that dividend paying firms had experienced stock price increment along with dividend payments rather than a reduction in the cost of capital. On the hand, the authors reported that non-dividend paying firms experienced a reduction in their cost of finance and an investment stimulus, which is consistent with the dividend taxation hypothesis. In conclusion, all the above studies are consistent with the dividend clientele hypothesis.

Empirical studies of the clientele effect hypothesis via the examination of the ex-dividend day behaviour of share prices have also been carried out in countries other than the USA, but with mixed results (Lakonishok and Vermaelen, 1983; Booth and Johnston, 1984, Dasilas, 2009). Lakonishok and Vermaelen (1983) employed the Elton and Gruber (1970) approach to examine the effect of major tax reform on ex-day behaviour on the Canadian Stock Market. The authors documented that the ex-day price was less correlated to dividend yields and was not affected by the change in taxation differences of ordinary income and capital gains. The authors concluded that the effects are more likely to be a short-term trading effect than a tax clientele effect. Booth and Johnston (1984) extended the work of Lakonishok and Vermaelen (1983) and examined the ex-dividend day price ratio for Canadian firms quoted on the Toronto Stock Exchange over four different tax regimes between 1970 and 1980. The authors reported that the ex-dividend day price ratio was significantly different from one. The authors concluded that the ex-dividend day price ratio does not provide much evidence in support of dividend tax clienteles. More recently, Dutta *et al.* (2004) examined the ex-dividend day price and volume behaviour in the Canadian Stock Market. Unlike previous studies, the authors provided evidence on the co-existence of both tax and short-term trading effects. The authors found evidence of short-term trading which is consistent with the dividend capturing activities around the ex-dividend day.

Finally, another strand of empirical testing has studied the relationship between dividend changes and clientele changes. These empirical studies attempt to investigate whether the observed increase in firm's stock trading volume was as a result of investors in various tax clienteles adjusting their portfolios. Empirical support for the existence of clientele trading is mixed (Richardson *et al.*, 1986; Dhaliwal *et al.*, 1999; Seida; 2001). For example, Richardson *et al.* (1986) examined the relationship between observed increase in firms' stock trading

volume and tax clienteles by employing a sample of 192 US firms that initiated dividends for the first time during the period 1969 through 1982. The authors found weak evidence between increased trading volume and clientele effect. However, Dhaliwal *et al.* (1999) investigated institutional shareholding changes following a dividend initiation. The authors found that there was an increase in institutional ownership subsequent to dividend initiations, consistent with the dividend clientele hypothesis. Overall, the empirical evidence of the tax argument is mixed.

To sum up, personal income from dividends are taxed at a higher rate than long-term capital gains for many investors. In addition, capital gains are not taxed until the gains are realized. This delay option of the incidence of the tax lowers the effective tax rate of capital gains even further. The tax effect theory suggests that stocks yielding higher dividends should earn larger pre-tax risk-adjusted returns, while long-term investors should require a pre-tax rate of return premium to induce them to hold stocks paying dividends. Many researchers have examined the implication of the tax effect hypothesis, but the results are inconclusive.

3.4.3 Dividends and the Bird-in-the-Hand Argument

A key assumption in the Miller and Modigliani (1961) dividend irrelevance hypothesis is that investors are rational. In the real business world, investors are systematically irrational with regard to decision making. Therefore, in the absence of investor rationality, a managed dividend policy may have an impact on firm value. Investors prefer a managed dividend policy to provide discipline in their investment and consumption decisions (Thaler and Shefrin, 1981; Shefrin and Statman, 1984). This sub-section discusses how market imperfection, such as irrational investor behaviour can make the dividend decision relevant.

3.4.3.1 The Bird-in-the-Hand Theory

The bird-in-the-hand theory or risk reduction argument is the traditional argument in favour of dividend relevance to firm value. This theory advanced by Graham and Dodd (1934) and extended by Lintner (1962) and Gordon (1959;1963) asserts that by paying dividends the firm brings forward cash inflows to shareholders, thereby reducing the uncertainty associated with future cash flows. Dividends represent a more reliable form of returning

profit to shareholders than capital gains because share prices are highly variable. Distribution of cash through dividends therefore increases firm value because dividends represent a “certainty” while capital gains are uncertain (Lintner, 1962; Gordon, 1963; Walter, 1963). The traditionalists assert that investors value the dollar which they receive from cash dividends more than the dollar they receive from capital gains. In this context, Graham and Dodd (1934) argued that a dollar of dividends has, on average, four times effect on stock price as a dollar of retained earnings.

The basic argument in favour of the bird-in-the-hand theory is that investors’ place value on the tangible nature of dividends relative to a possible capital gain. Dividends are perceived to be less risky than capital gains, because capital gains depend not only on the profitable reinvestments of earnings by the company, but also upon movements in the overall stock market (Kester and Robins, 2011). Gordon (1963) opined that the existence of uncertainty about the future suffices to make the price of shares vary with the dividend policy adopted; and in particular, the more generous the dividend policy, the higher the price of share. Investors’ perception of lower risk reduces the discount factor and increases the market value of shares. Because dividends are less risky than capital gains, the proponents of this theory argue that firms should adopt high dividend payouts in order to maximize their share price (Lintner, 1962; Gordon, 1963). Therefore, traditionalists concluded that dividends are relevant to share valuation.

Notwithstanding the persuasiveness of the bird-in-the-hand argument, the theory has been criticized by some researchers who are of the view that the firm’s required rate of return is independent of its dividend policy because investors are indifferent between dividends and capital gains. Miller and Modigliani (1961) present a plausible argument against the bird-in-the-hand argument by contending that a firm’s risk is influenced by the riskiness of its operating cash flow, but not by the way the firm distributes its income. Consequently, Miller and Modigliani nicknamed this theory the “bird-in-the-hand fallacy”. Bhattacharya (1979) also argues that if the riskiness of a firm’s cash flow determines a firm’s risk, then the reasoning behind the bird-in-the-hand hypothesis is fallacious because an increase in dividend payout will not enhance a firm’s value by reducing the riskiness of future cash flows.

In summary, the bird-in-the-hand theory suggests that investors place value on the tangible nature of a cash disbursement relative to a possible capital gain. The proponents of this theory believe that cash dividends are attractive to shareholders because they are less risky than promises of growth (capital gains). As a result of this preference, investors pay higher prices for a company's shares with cash dividends compared to a company that holds their profits when other factors are fixed. Therefore, this theory indicates that if the company wants to maximize their share price, then they should adopt a high dividend payout ratio.

3.4.3.2 Empirical Evidence

Empirical studies of the bird-in-the-hand explanation for paying dividends are generally very limited. However, some researchers have examined the hypothesis using regression models to estimate the influence of dividends and retained earnings on share price. Gordon (1959) examined the bird-in-the-hand hypothesis and found that dividends have greater influence on share price than retained earnings. Fisher (1961) reported results consistent with Gordon (1959) using data from the UK during the period between 1949 and 1957. Other studies (e.g. Gordon and Shapiro, 1956; Lintner, 1962; Gordon, 1963; Walter, 1963) provided evidence which suggests that investors prefer cash dividends to capital gains; these evidences are consistent with the bird-in-the-hand hypothesis. In contrast, Diamond (1967) examined the effect of dividends and retained earnings for a sample of 255 US firms during the period 1961 and 1962. The results show only weak evidence for the argument that investors prefer dividends to capital gains. This result is similar to those reported by Friend and Bucket (1964).

Other researchers have studied the bird-in-the-hand theory by investigating the views of corporate managers' involved in the administration of dividend policy of their firms. Evidence from survey research has tended to be dismissive of the bird-in-the-hand explanation of dividend relevance (Baker and Powell, 1999; Baker *et al.*, 2002). For instance, Baker *et al.* (2002) surveyed the managers of NASDAQ firms that consistently pay dividends to determine whether their shareholders prefer dividends over capital gains. The authors found no support for the bird-in-the-hand explanation for paying dividends. However, recent survey evidence from an emerging market indicates that publicly listed firms in Barbados had a strong sense of dividends being a reward for investing, quite separate and

distinct from capital gains, suggesting support for the bird-in-the-hand explanation for paying dividends (Robinson, 2006). Based on the studies above, the evidence on the bird-in-the-hand explanation is at best mixed.

From the preceding analysis, it is clear that market imperfections are the key to the relevance of dividend policy. The last section provided a discussion of one of the market imperfections- information asymmetry, while the current section provided a detailed discussion of the three of these market imperfections- agency costs, taxes, and irrational investor behaviour. The next section deals with the contribution of behavioural finance in the explanation of the endurance of corporate dividend policy. It also reviews the prior studies on dividend behaviour of management in developed capital markets.

3.5 Dividend Policy and Behavioural Finance

None of the models discussed in the preceding sections completely explained the observed corporate dividend behaviour. Shiller (1984) noted that investor behaviour is substantially influenced by societal norms and attitudes. Hence, solving the dividend puzzle is impossible while ignoring the patterns of normal investor behaviour (Shiller, 1989; Statman, 1997). Dividend policy is better explained by the addition of a socioeconomic- behaviour paradigm into economic models. Thus, dividends are partially a tradition and partially a method to allay investor anxiety (Frankfurter and Lane, 1992). This section discusses the theoretical behavioural models of dividend policy and also reviews the prior literature on the dividend behaviour of management in developed markets.

3.5.1 Theoretical Behavioural Models of Dividend Policy

Behavioural finance theory of dividends contends that individual investors prefer dividends over capital gains despite the tax differential. The rationale behind this preference is that investors want to follow a self-disciplined financial plan to grow their capital and prevent impulsive spending behaviour which might occur in the short-run. In the judgement of investors, benefits gained from self-discipline surpass the negative effect of tax differential to their wealth (Shefrin and Statman, 1984).

According to Feldstein and Green (1983), the corporate dividend decision is the last step in a process that evaluates inputs from five sources. First, dividend policy is a consequence of investor consumption needs. Second, the market value of retained earnings is less than the market value of dividends. Third, dividend payment is consistent with steady state growth and an optimal debt/equity ratio. Fourth, dividend payments are a by-product of the separation ownership and control. Finally, the involvement of shareholders with diverse tax liabilities and diversification goals in an equilibrium with uncertainty results in dividend payments (Frankfurter and Wood, 2002, p. 117).

Shefrin and Statman (1984) developed a framework that explains why investors prefer dividends to capital gains using the theory of self-control (Thaler and Shefrin, 1981) and the descriptive theory of choice under uncertainty (Kahneman and Tversky, 1979). Dividends and capital gains do not have the same value in a world modelled using the theory of self-control; rather, investors prefer dividends to capital gains because dividends provide an automatic control device on spending levels (Thaler, 1980). In a similar vein, dividends and capital gains are not always perfect substitutes due to a lack of self-control to delay gratification (Thaler and Shefrin, 1981). On the other hand, Kahneman and Tversky (1982) postulate that the sale of shares of stock causes more investor regret and anxiety than spending of the cash received from dividend payments.

3.5.2 Dividend Behaviour of Managers

The pioneering study on the dividend behaviour of management was undertaken by Lintner (1956) who interviewed 28 corporate managers of US major industrial 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. This reluctance in reducing dividends in the part of management led to stable dividend payment because management is unwilling to cut their firm's dividend payout in the future as this might convey a negative signal to investors. Lintner also stated that in two-thirds of the companies investigated, 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. Specifically, the author stated that firms had

a target payout ratio with an average of about 50.0%. Lintner (1956) also documented that there was an incremental adjustment on a yearly basis to achieve the target payout level and that the average adjustment factor was found to be 30.0% for the entire sample.

According to Lintner (1956), the best predictors of current year's dividends are the earnings in the current year and the dividend paid in the previous year. Based on this field work, Lintner (1956) developed the partial adjustment model of dividends which can be summarised in the following equations:

$$D_{it} = a_i + c_i (D^*_{it} - D_{it-1}) + U_{it} \quad [3.1]$$

Or
$$D_{it} = a_{it} + b P_{it} + d D_{it-1} + U_{it} \quad [3.2]$$

Where D_{it} is the change in dividend; D_{it} is the dividend in the current year; D_{it-1} is the dividend in the previous year; a_{it} is the constant term; c_i is the speed of adjustment factor; U_{it} is error term; and D^*_{it} is the target payout which is a function of the current year's profits (P_{it}). This equation showed that a change in dividends is a function of the difference between a firm's target dividend payout and the previous year's dividend payout multiplied by a speed of adjustment factor. In addition, these equations also showed that the dividend depended upon the earnings in the current year (P_{it}) and the dividend in the previous year (D_{it-1}). Lintner (1956) tested this model by fitting pre-war annual data from 1918 to 1941 to Equation 3.2 and found that the model explained 85.0% of the changes in dividend. He also used the same data on post-war dividends, and discovered that the model produced a minimum mean square error of 6.4% as compared to other naïve prediction models where the error rate was 7.8%.

Despite the contribution of Lintner's (1956) behavioural model of dividend policy, Michaelson (1961) argued that Lintner's model of dividend determination, in which the target payout ratio is the main parameter, is thus unsatisfactory on both theoretical and empirical grounds. The author noted that Lintner used aggregate time-series data as the main object of his analysis, and made no rigorous attempt to show that earnings and dividends for the corporate sector as a whole might be treated as observation of a single firm and that such observations for several consecutive years might be treated as independent observation for similar firms. However, Brittain (1966) and Fama and Fabiak

(1968) reevaluated Lintner's model and concluded that Lintner's basic model continued to perform well relative to alternative specifications using both economy wide earnings and dividend data and data for individual firms. Specifically, Fama and Fabiak (1968) employed regression, stimulation and prediction methods to test different models of dividend changes to improve on the equation put forward by Lintner⁹ using data for 392 US firms over the period 1946-1964. The authors found that Lintner's equation performed well in comparison to other models examined. Specifically, the authors documented that the coefficient determination (R^2) for Lintner's model at 0.432 was the highest achieved.

Numerous dividend surveys were undertaken in the wake of Lintner's (1956) study in the US (Fama and Fabiak, 1968; Baker *et al.*, 1985; Fama, 1974; Pruitt and Gitman, 1991; Benartzi *et al.*, 1997; Baker and Powell, 1999; 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, Fama and Fabiak (1968) conducted an empirical analysis of the dividend behaviour of 392 US firms and reported that Lintner's model performed well in comparison to other models of dividend policy. In a similar vein, Baker *et al.* (1985) surveyed the chief executives of 562 US firms from three industry groups (utilities, manufacturing, and wholesale/retail), 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. Recent evidence by Brav *et al.* (2005) also suggested that management follow the Lintner (1956) model when deciding on the dividend-setting process.

Many researchers have investigated the dividend behaviour of management in countries other than the US and documented results that broadly support the Lintner's (1956) conclusions (Partington, 1985; Dhanani, 2005; McCluskey *et al.*, 2007; Baker *et al.*, 2008; Kester and Robbins, 2011). For example, in a postal survey of 93 large Australian companies, Partington (1985) found that managers perceived dividends to be important in signalling

⁹ The authors employed five naïve models as well as nine regression models with modifications to Lintner's model for prediction purposes.

their views about future profitability. The authors also reported respondents attached considerable importance to meeting shareholders' requirements for income and maintaining shareholder loyalty. Dhanani (2005), using a sample of 1000 UK firms (comprising of the top 800 LSE firms and the top 200 AIM), found that managers support the general dividend relevance hypotheses, in which dividend policy serves to enhance corporate market value. Recently, McCluskey *et al.* (2007) interviewed the financial directors of 20 leading Irish companies to provide a modern perspective on the role of dividends in smaller developed countries. The authors reported that Lintner's model remains the best description of the dividend-setting process in that 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.

In a more recent study, Baker *et al.* (2008) investigated how industry classifications affect managerial perspectives on dividend policy. The authors surveyed the managers of financial and non-financial firms listed on the Toronto Stock Exchange (TSE), using a postal questionnaire. The results of their study are similar to those reported by Linter (1956) and support the notion that firms follow a conservative dividend policy and typically determine their current dividend payout based on the level of current and expected future earnings. However, the authors documented that management perception of the factors that influence dividend policy differs between financial and non-financial firms. Specifically, the authors reported that while managers of financial firms give the highest support to the stability of earnings, expected rate of return on the firm's assets, and industry's dividend payout ratio as factors affecting dividend policy, their counterparts from non-financial firms give more weight to the level of expected future earnings, the current degree of financial leverage and financing considerations such as the cost of raising external funds.

The next section reviews the extant literature on the dividend behaviour of companies in countries with emerging stock markets. The review focus on two areas: (i) the impact of dividend announcements on share prices; (ii) views of management about the determinants and relevance of dividend policy to firm value in the context of emerging markets. The review of prior dividend literature in emerging markets is necessary in order to provide the background within which the empirical work in the current thesis can be compared.

3.6 Industry Classification and Dividend Policy

A key factor used in the literature to explain variations in dividend policy is industry classification. Dividend policy is considered to be more important for financial firms in that maintaining financial health is central to the daily operations of the financial firms than non-financial firms (Baker *et al.*, 2008). In a study of the dividend policy of US firms, Lintner (1956) noted that industry type may influence corporate dividend policy. For example, matured and well established companies have higher propensity to pay dividends than newly established and high-growth companies.

The impact of industry classification on dividend policy can also be explained based on herding behaviour. Herding behaviour is defined as the tendency of other firms to make similar decisions as the 'market leader' or 'first declarer' of the cash dividend (Baker and Smith, 2005). They authors investigated herding behaviour in dividend policy of 43 industries over the period 1982-2001 and found evidence in support of the herding behaviour.

Many studies have examined whether industry classification affects dividend policy, but the evidence is inconclusive. Some studies found evidence in support of an industry effect on dividend policy (Baker *et al.*, 1985; Baker, 1988; Barclay *et al.*, 1995; Baker and Powell, 1999; Baker *et al.*, 2001; Baker *et al.*, 2008). For example, Baker *et al.* (1985) reported differences in the views of managers on the factors influencing dividend policy between more regulated (utility) and less regulated (manufacturing and wholesale/retail) industry groups. Similarly, Baker *et al.* (2001) found differences in the perceptions of managers of financial and non-financial NASDAQ firms on 9 of the 22 factors influencing dividend policy.

Other studies on industry effect on dividend policy, however, documented weak or no support for an industry-related dividend effect (Howe and Shen, 1988; Dempsey *et al.*, 1993; Casey *et al.*, 1999; Frankfurter and Wood, 2003). For example, Howe and Shen (1988) examined the effect of intra-industry information on dividend initiation. The authors reported no significant association between intra-industry information and dividend initiation and concluded that dividend initiation is a firm-specific event. Similarly, Frankfurter and Wood (2003) found no evidence of systematic relationship between industry type and dividend policy. The authors suggested that differences in dividend

policy by industry might be the sole effect of firm size. While controlling for firm-specific factors, Dempsey *et al.* (1993) investigated for industry effects in the US market within two sub-periods (1974 to 1980; 1980 to 1987). The authors documented only a modest industry effect and called for further research to more fully explore this issue. Casey *et al.* (1999) investigated whether dividend policy within different industries responded differently to the Tax Reform Act of 1986 and found weak support for an industry-related dividend effect.

In a more recent study, Baker *et al.* (2008) investigated the effect of industry classification on the perceptions of managers of Canadian financial versus non-financial firms on dividend policy. Specifically, the authors examined the industry effects on the factors influencing dividend policy, dividend pattern, dividend setting process, dividend policy and firm value, residual dividend theory, and explanations for paying dividends. The authors reported that the perceptions of the factors that influence dividend policy differ between managers of financial and non-financial firms. The authors also documented that industry classification affects how managers view statements about the dividend pattern, dividend setting process, dividend policy and firm value, residual dividend theory, and explanations for paying dividends. The authors concluded that industry classification affects managerial perceptions on dividend policy.

3.7 Dividend Research in Emerging Stock Markets

To date, the research on the dividend policy and stock market reaction to dividend announcements show a bias in favour of firms in countries with developed capital markets, as most of the research on dividend policy were conducted in these countries. The current section reviews the few studies conducted on this topic in the emerging markets. The review of studies in other emerging markets facilitates a greater level of comparability with the results of the present study because of the relative homogeneity of the markets and the similar economic/institutional environment which they share with Nigeria.

3.7.1 Dividend Announcements and Share Prices

Examination of share price reaction to dividend announcements has also been extended to emerging markets, albeit relatively few. Bandara (2001) examined the information content

of dividend announcements using data from the 37 companies that made 123 dividend announcements at the Colombo Stock Exchange (CSE) of Sri Lanka during the period 1993 to 1998. The results of the study support the notion that stock prices react to dividend announcements. In particular, the author documented that the market reacted positively to the announcement of dividend increase and negatively to the announcement of dividend decrease. For the dividend-no-change announcements, the author documented no significant reaction. In a similar vein, Travlos *et al.* (2001) examined the stock price reaction to the announcements of cash dividends in Cyprus and documented positive abnormal returns on the dividend announcement date. The authors also recommended that firms operating in emerging markets should adopt a payout policy that suits the characteristics of their stock market, such as market microstructure and tax treatment of dividends.

Despite this weight of evidence, a study by Chen *et al.* (2002) on the share price reaction to the announcement of concurrent earnings, cash dividends, and stock dividends in the Chinese stock market did not find evidence in support of a share price reaction to dividend announcements. Specifically, the authors documented that cash dividends have no clear association with stock returns in the sample companies studied. Their results suggest that the variability of dividends diminishes their information content. In a similar vein, Akbar and Baig (2010) examined the reaction of stock prices to dividend announcements in Pakistan during the period 1 July 2004 to 29 June 2007 and reported negligible abnormal returns for cash dividend announcements. However, a recent study by Hu Zuguang and Ahmed (2010) covering the period January 2005 to December 2009 did uncover a significant share price reaction to dividend announcements in Shanghai Stock Exchange. In particular, the authors reported positive abnormal returns for the dividend-increasing companies during the dividend announcement date. However, for the dividend-decreasing companies, the authors found that the market did not experience any negative abnormal returns suggesting that investors in the Shanghai stock market do not regard dividend decrease as a negative signal. The authors also found that significantly large dividend increase announcement has much higher effect on the value of abnormal returns suggesting that size of the dividend increase was an important consideration to the investors.

Dasilas and Leventis (2011) examined the market reaction to cash dividend announcements employing data from the Athens Stock Exchange (ASE) for the period 2000-2004.

Specifically, the authors investigated both the stock price and trading volume reaction to dividend announcements. The result of their study is similar to those reported by Bandara (2001) and supports the notion that share price reacts to dividend announcements. The authors documented a statistically significant market reaction to dividend change announcements, which lend credence to the information content hypothesis of dividend signalling. In particular, the authors reported that dividend increases induced a significant positive stock price reaction, whereas dividend decreases brought about a significant negative price reaction for the sample companies. Their results also show that the trading volume move in the same direction as the dividend change signals.

Other researchers have also investigated the market reaction to dividend announcements using emerging markets data and have documented results that support the information content hypothesis of dividend signalling (Aamir and Ali Shah, 2011; Al-Yahyaee *et al.*, 2011; Sharma, 2011). For example, Al-Yahyaee *et al.* (2011) examined the share price reactions to cash dividend announcements, using data from the universe of Omani companies announcing cash dividends from January 1, 1997 to August 31, 2005. Specifically, the authors examined the tax-based signalling hypothesis, which suggests that dividends would not be informative if not for the higher taxes on dividends relative to capital gains. The authors reported that the market reacts strongly to the announcement of changes in cash dividends; in particular, dividend increases resulted in positive price reaction, while dividend decreases resulted in negative price reactions for the sample companies studied. The authors concluded that despite the fact that Omani's stock market is young and investors have limited knowledge and expertise, the dividend announcements are used by investors as information-signals.

Very recently, Dharmarathne (2013) examined the stock market reaction to dividend announcements and information efficiency in the Sri Lankan stock market using a sample of 61 companies that made 137 dividend announcements during the period 1999-2005. The author divided the sample into three groups based on their dividend-change announcements. The author documented that share prices react to dividend announcements in Sri Lanka, implying that dividends contain price-sensitive information. Specifically, the author documented that the average abnormal returns for both the dividend-increasing and dividend-decreasing companies were positive during the

announcement date, suggesting that the stock market reacts positively when a dividend decrease announcements are made in Sri Lankan stock market. Finally, the author also found evidence which suggests that the market reacts earlier than the actual announcement of dividend changes, suggesting that there is information leakage in the market.

3.7.2 Managerial Views about Dividends in Emerging Markets

Very few studies have analysed the dividend behaviour of management in an emerging market context. Glen *et al.* (1995) were the first to study the dividend policy decisions of firms in emerging markets. The authors found that the payout ratios in developing countries are typically much lower than that of developed countries, and that firms in emerging markets exhibit high volatility of dividends over time. The authors also reported that shareholders and governments exert significant influence on dividend policy and that dividends have little signalling content.

Chazi *et al.* (2011) examined the field practice of dividend policy in an emerging market in the UAE, using both questionnaires and field interviews. Their results provide support for the proposition that dividend policy is conservative. Specifically, the authors reported that companies are reluctant to reduce dividends and that they typically determine their payout policy based on current year's earnings and the past dividend payments. The authors also found that 'dividends in UAE are considered by managers as a residual cash flow, and are determined after investment decisions are made' (Chazi *et al.*, 2011, p.257). With regards to the determinants of dividend policy in the UAE, the authors found that taxes are immaterial; that institutional investors are expected to play a role in disciplining managers, and that dividend may play a disciplinary role in controlling agency conflicts. Finally, the authors found support for the signalling function of dividend policy.

Khan *et al.* (2011) investigated the managerial views about dividend policy in Pakistan, using interviews. Their results indicate that despite differences in institutional environment between emerging and developed markets, the dividend-setting process in Pakistan were similar in many respects to those in the US and other developed capital markets. In particular, the authors reported that Pakistani companies focus on current earnings and liquidity when deciding on a disbursement level. However, the authors suggested that past dividends do not influence the current dividend levels in Pakistan and that companies were

not reluctant to announce news of a dividend cut. The next section deals with the few studies conducted on dividend policy using Nigerian data.

3.8 Prior Research on Dividends in Nigeria

The dividend decision of Nigerian companies has been examined by a number of studies (Uzoaga and Alozienwa, 1974; Inanga, 1975: 1978; Soyode, 1976: 1978; Odife, 1977; Okafor, 1983; Izodonmi, 1996; Olowe, 1998; Osuala, 2006; Nnamdi, 2009; Akujuobi and Nnamdi, 2010). However, the empirical work contained in these studies employed different statistical methodologies and arrived at contradictory conclusions. The review in this section divided these prior studies into two: (i) those dealing with the determinants of dividend policy, and (ii) the impact of dividend announcements on share prices.

3.8.1 Determinants of Dividend Policy

A number of prior studies have examined the dividend decision of Nigerian companies using the framework of Lintner (1956). For example, in a study of the dividend policy followed by Nigerian companies on the eve of indigenization, Uzoaga and Alozienwa (1974) reported that the “excessive” dividend payouts which depleted the companies reserves and retained earnings is not in line with the Lintner’s (1956) model where current dividends is influenced by the level of current earnings and the previous dividends. They concluded that fear and resentment seem to have taken over from the classical forces. However, Inanga (1978) and Soyode (1976, 1978) contend that that the determinants of dividend policy in Nigeria were neither clearly identified nor were their relative impacts estimated by Uzoaga and Alozienwa. In particular, Inanga (1978) attributed the change in dividend policy during to the share pricing policy of the Capital Issue Commission (CIC) which seemed to have ignored the classical factors that should govern the pricing of equity share issues.

Oyejide (1976) empirically tested for company dividend policy in Nigeria employing the Lintner’s model as modified by Brittain (1964) and found a statistical significant relationship between current dividends and past year net profits. This finding supports the Lintner’s model of dividend policy. Odife (1977) disagreed with Oyejide (1976) on the ground that the

study failed to adjust for stock dividends. However, Izedonmi and Eriki (1996) investigated the determinants of dividend policy in publicly listed firms in Nigeria using published financial data from 1984 to 1989. They authors found support for the Lintner's model of dividend policy.

Adelegan (2003) examined the incremental information content of cash flows in explaining dividend changes, given earnings, using a total of 63 listed companies that generated an 882 firm-year data covering the period 1984 to 1997. The author reported a significant relationship between cash flow and dividend changes. In a similar vein, in a study on the determinants of corporate dividend policy in Nigeria, Osuala (2005) reported that profitability and return on equity affect dividend payments, while Nnamdi (2009) identified the existence of a significant relationship between dividend and current and past earnings, in a study of earning-dividend relationship in Nigeria. These studies therefore provide evidence in support of the notion that Lintner's model is descriptive of the dividend policies pursued by Nigerian companies.

A more recent study by Akujuobi and Nnamdi (2010) documented that Nigerian firms generally follows the Lintner's model. Using a regression analysis, the authors evaluated the predictive efficacies of current-and one-year-lagged earnings of 104 publicly listed firms in Nigeria. Their results indicate that dividend payouts are relatively more sensitive to current earnings per share compared to past earnings per share. The authors therefore concluded that the current earnings model is relatively more effective in predicting the dividend payouts of Nigerian listed companies.

In summary, the review of prior studies show that most of these studies made use of aggregated regression analysis in their examination of the dividend decisions in Nigeria. The contradictory finding reported in these studies is therefore due to the different methodologies employed. There is no prior evidence on managerial perspectives on dividend policy in Nigeria. The current thesis attempts to address the ambiguities in prior research by investigating the views of corporate managers who are involved in the administration of dividend policy, using questionnaire and interviews. The thesis also examines how the Nigerian stock market reacts to corporate announcements about dividend payments using the standard event study methodology.

3.8.2 Relationship between Dividends and Share Prices

The impact of dividend announcements on share prices of Nigerian firms has been examined by a number of studies, albeit relatively few. The first attempt to examine the information content hypothesis of dividend announcements in the Nigerian stock market was made by Olowe (1998). The author investigated the share price reaction to stock dividends in Nigeria around ex-dates from 1981 to 1992 using monthly data. The author reported that share prices react to stock dividends before and after the ex-dates. The author argued that the investors did not anticipate the event, and as a result share prices did not adjust quickly as after the stock dividend announcements. The author concluded that the Nigerian stock market is not efficient in the semi-strong sense. However, a major deficiency of this study is that it failed to take into account other information which could have been announced at the same time as the stock dividend ex-dates.

Adelegan (2009) examined the stock market reaction to the announcements of dividend payments and omissions for 742 announcement dates. The study reported that the mean excess returns are generally negative for all the dividend omission subsamples, but are positive for dividend paying subsamples after the date of the announcement. The author further found that the cumulative excess returns are positive and significant for dividend paying firms, but are negative and statistically significant for dividend omitting firms. The authors therefore concluded that the findings support semi-strong inadequacies of the Nigerian stock market documented by Olowe (1998).

Campbell and Ohuocha (2011) examined whether stock dividend announcements create value for companies traded on the Nigerian stock market, using daily stock returns from 2002 to 2006. Specifically, the authors investigated the nature of the information conveyed by stock dividends in Nigeria by testing the cash distribution and signalling hypotheses. The authors divided their sample period into two based on the timing of the announcements and the frequency with which the announcing shares are traded. Their results suggest that companies that chose their own announcement date outside the NSE announcement window experience positive abnormal returns if their stock is more frequently traded and negative abnormal returns if their stock is less frequently traded. The authors also found support for both the cash substitution hypothesis and the signalling hypothesis.

3.9 Empirical Studies of the Semi-strong Market Efficiency

The semi-strong form efficiency of the efficient market hypothesis implies that stock prices reflect all publicly available information. Therefore, making systematic profits by trading based on this information is impossible (Fama, 1970). To test the semi-strong form efficiency, researchers have traditionally used the event study method to test the market response to an event by measuring market reactions in the period surrounding the event. The idea behind event studies is to see how quickly and accurately news is incorporated into the share price. If abnormal returns around the event date are statistically and significantly different from zero, then markets are considered inefficient (Fleming and Remolona, 1999).

The empirical literature on the stock market reaction to information disclosure is vast and covers a wide range of events, such as dividend announcements, stock splits, earnings announcements, macroeconomic policy changes, and merger announcements. The results from different studies indicated that stock markets react quickly and efficiently to information releases in developed markets, leaving no room for investors to consistently earn abnormal returns by trading based on publicly released information (Ball and Brown, 1968; Fama *et al.*, 1969; Petit, 1972; Ederington and Lee, 1995; Fiffield *et al.*, 2002). For example, Ball and Brown (1968) examined the information contained in the company reports (particularly earnings announcements) to see whether there is a significant change in security prices following the public release of the reports. The evidence indicated that, once an adjustment has been made for risk and transaction costs, most (i.e. about 90%) of the adjustment to earnings occur before the announcement is made. In particular, the authors documented that for the 'good news' companies, about 90 per cent (on average) of the increase in the share price took place in the twelve months prior to the announcement and only 10 per cent of the increase took place in the subsequent six months. A similar result occurred with 'bad news' companies. The evidence therefore suggests that securities markets are semi-strong-form efficient in the sense that no trading rule based on exploiting the information embodied in public earnings announcements will generate excess returns compared with a buy-and-hold strategy. Similarly, Fama *et al.* (1969) examined the impact of the information implied by stock splits on share prices in the US. The results indicated that the information was spontaneously incorporated into share prices upon its release such that there were no abnormal returns accrued to the announcement.

However, subsequent studies on the semi-strong market efficiency in developed markets have documented apparent instances of market inefficiencies (e.g. Charest, 1978; Copeland and Myers, 1982; Rendleman *et al.*, 1982; Kalay and Loewenstein, 1985). Charest (1978) examined the stock market reaction to dividend announcements and found evidence of sluggish market reaction to dividend announcements: shares earn abnormally high returns subsequent to announcements of dividend increases and abnormally low returns subsequent to dividend decreases, suggesting a trading profit opportunity. Rendleman *et al.* (1982) also documented evidence not consistent with the semi-strong form market efficiency. The authors examined the share price reaction to earnings announcement and reported that the reaction of share prices is not entirely consistent with the semi-strong efficient market hypothesis. Specifically, the authors separated firms into 10 groups according to the degree of good or bad news contained in the quarterly earnings announcements. They documented that in the 20 days prior to the announcement the share prices tended to move in anticipation of the announcement, with the return on 'good-news' firm's stock rising and the return on 'bad-news' stock declining. This evidence suggests that a degree of inside knowledge was being priced into the stock prior to the announcement. However, they also observed that while there was a discernible share price movement on the day of the announcement consistent with the market efficiency, there was also significant and predictable returns to be made in the 90 days following the announcement, which is inconsistent with the market efficiency. Kalay and Loewenstein (1985) examined the market's ability to form unbiased expectations by examining whether or not the net announcement effect across all dividend announcements sum to zero. The authors found evidence of a positive net announcement effect, contrary to the implication of market rationality (i.e. efficiency).

Examination of informational efficiency has been extended to the African stock markets, although relatively few. Olowe (1998) examined the response of stock prices to stock splits in Nigeria between 1981 and 1992 using monthly data. The author failed to find evidence of efficiency, and thus concluded that the Nigerian stock is not information efficient. However, the author failed to isolate the price-impact of other simultaneous events occurring near the dates of announcements of stock splits and this may have influenced the overall results of the study. In a similar vein, Oludoyi (1999) examined the stock price

reaction to earnings announcements in Nigeria using weekly data. The author found evidence that suggests that the Nigerian stock market is not semi strong form efficient as stock prices drift 10 weeks after the announcement of corporate earnings.

Employing weekly price data from the Ghanaian stock market, Osei (2002) examined the market response to annual earnings announcements of a sample of 16 firms over the period 1992-1997. The author reported that share prices continue to drift in response both favourable and unfavourable news beyond the earnings announcement week, implying that sluggish price adjustment. The author concluded that the Ghanaian stock market is not efficient in the semi-strong firm. Adelegan (2009) examined the speed of share price adjustment to dividend announcements in Nigeria. The author reported that dividend announcements do contain information relevant to price formation; dividend paying firms experienced significant positive abnormal returns for 30 days from the date of dividend announcement, while dividend omitting firms experienced significant negative abnormal returns over the same period. The author concluded that the Nigerian stock market is informationally inefficient. Very recently, Afego (2011) examined the stock price response to earnings announcements in Nigeria during the period 2005-2008. The author found evidence inconsistent with the efficient market hypothesis in that the cumulative abnormal returns is dominated by significant reactions 20 days before and after the earnings announcements.

From the review of literature on informational efficiency of the Nigerian stock market, it emerged that most of the studies relied on monthly and weekly data. In addition, these studies were conducted prior to 1999 when the NSE adopted the use of automated trading system. It is expected that technological development, coupled with recent reforms in financial market regulation and increased integration and internationalization of the Nigerian capital market may have increased the availability of information and this will have important implications for the efficiency of the Nigerian stock market (Afego, 2011). The current thesis makes an important contribution to the literature by using recent and daily price data in the examination of the stock market reaction to dividend announcements in Nigeria. With the use of daily prices, current trends in the behaviour of stock prices around dividend announcements will be captured.

3.10 Conclusion and Gap Identification

This chapter provided a detailed discussion of the conflicting theories and empirical studies on dividend policy. Specifically, the chapter explored all the theories that have been advanced to explain the impact of dividend distributions on the value of a firm. The review started with the classical dividend irrelevance hypothesis of Miller and Modigliani (1961), which argues that dividends do not affect firm value in perfect capital markets as investors can undo any dividend policy effect without changing the value of the firm to the dividend relevance literature advanced by Graham and Dodd (1934), Gordon (1959) and Lintner (1962) which contends that a managed dividend policy is critical to the value of a firm. From the review of the literature, it was observed that contrary to the theoretical assumption of the Miller and Modigliani's (1961) dividend irrelevance hypothesis, empirical studies of the impact of dividend announcements on share prices show that significant price reactions occur on the dividend announcement day (Petit, 1972; Charest, 1978; Aharony and Swary, 1980; McCluskey *et al.*, 2006; Al-Yahyaee *et al.*, 2011).

In the course of the literature review presented in this chapter, several gaps were identified in the dividend literature:

- Most of the research effort on dividend policy focused almost exclusively on countries with developed capital markets; there are very few studies on the dividend policy of firms in emerging markets.
- The dividend behaviour of managers of financial and non-financial firms is often studied separately, despite the suggestions in prior research that industry classification affects dividend policy managerial views about dividends (see Baker *et al.*, 2001). Hence, we have limited knowledge on how industry classifications influence the views of managers of financial and non-financial firms on dividend policy.
- There is no prior study of managerial perspectives on dividend policy applied to the Nigerian context. The very few studies on dividend payments in Nigeria employed regression analysis to determine the factors that influence dividend policy. As a result, there is no evidence on the perceptions of Nigerian corporate managers about dividends.

- Despite the exhortations by academics for a broader investigation of the dividend puzzle (i.e. one which adopts both behavioural and empirical approaches); most research on dividend policy adopts either a behavioural or empirical approach in their investigations. It is very rare to find prior research on dividends that employed a synthesis of various research methods in a single study. The consequence of using one single method in a study is that it puts a limit on the depth, reliability, and validity of findings.

The current thesis seeks to address these gaps in the literature. Specifically, given the large body of evidence on dividend effects in countries with developed capital markets, there is need for “triangulation” in the research by providing evidence from countries with emerging markets. The thesis therefore seeks to extend the dividend debate to the realm of emerging markets by investigating the dividend policy and the impact of dividend announcements on share prices of listed companies in Nigeria. Nigerian is an emerging market characterised by thinness of trading and firms have concentrated ownership structure contrary to developed markets. In addition, the thesis investigates whether the perceptions of the factors that drive dividend decision differ between managers of financial and non-financial firms. Finally, unlike prior studies, this thesis adopts both behavioural and empirical approaches in the investigation of the ‘dividend puzzle’ in the Nigerian context. In particular, the thesis employs a mixed methods research design, consisting of a questionnaire survey, an event study method and interviews in order to enhance the robustness of the results. Thus, in mixed methods research, the weakness of one method can be offset by the strengths of the other.

CHAPTER FOUR

RESEARCH METHODOLOGY AND METHODS

4.1 Introduction

Chapter 3 reviewed the theoretical and prior empirical literature on the 'dividend puzzle' and noted that despite the lack of consensus among academics on the impact of dividend announcements on the value of the firm, practitioners behave as though dividend policy does matter. Despite the fact that distribution of earnings in the form of dividends is less advantageous from a tax perspective than capital gains, companies continue to pay dividends. Based on the review of this literature, it was apparent that despite the various theories offered by academics to explain why firms distribute dividends and the impact of such disbursements on firm value, the dividend policy issue still remains a puzzle as no single convincing explanation has been given as to why companies pay dividends.

The current chapter discusses the research methodology and methods that were employed in carrying out the research in this thesis. The chapter discusses the nature of social science research as well as the philosophical assumptions underpinning the design of the present study. In the context of these assumptions, the decision to conduct the research within the pragmatic philosophical paradigm, the combined use of quantitative and qualitative modes of inquiry, and the use of mixed methods research design consisting of a questionnaire survey, a standard event study method, and interviews in the investigation of the dividend policy and stock market reaction to dividend announcements documented in the subsequent chapters are explained.

The remainder of this chapter is organised as follows. Section 4.2 discusses the theoretical underpinning of dividend research while Section 4.3 explains the philosophical assumptions that underpinning the research in the current thesis. Section 4.4 discusses research design and also identifies and explains the distinction between quantitative, qualitative, and mixed methods research designs. This section also explains the motivations underlying the choice of mixed methods research design, consisting of both quantitative and qualitative approaches in the investigation of the 'dividend puzzle' in the present study. Section 4.5 provides a detailed description of each of the three research methods employed in this thesis. Section 4.6 explains how the research will progress in the context of the triangulation

involved in using a questionnaire survey, a market-based event study and semi-structured interviews. Finally, section 4.7 concludes the chapter.

4.2. The Theoretical Framework of the Research

The theoretical framework of the research in this thesis is based on the dividend relevance literature, which suggests that a positive relationship exists between dividends and firm value. This hypothesis relies on the relaxations of the assumptions of perfect capital markets to offer theories that explain how dividends can influence the value of a firm in a world characterised by market imperfections. Although numerous theories exist, this thesis focuses on four standard explanations for paying dividends: (i) *Bird-in-the-hand theory*: this theory asserts that investors prefer cash in the hand rather than future promise of capital gains because share prices are highly variable (Gordon, 1963; Walter, 1963); (ii) *Signalling explanation*: This is the most prominent theory, and it explains dividends as a means to mitigate information asymmetry between managers and outside shareholders by conveying private information to investors about a firm's current performance and future prospects (Bhattacharya, 1979; John and Williams, 1985; Miller and Rock, 1985); (iii) *Agency theory*: This theory explains dividends as a means to reduce the agency costs associated with separation of ownership and management (Jensen and Meckling, 1976; Rozeff, 1982; Easterbrook, 1984; Jensen, 1986); and (iv) *Tax preference and clientele effects*: This theory posits that differentials in tax rates between dividends and capital gains lead to different class of shareholders attracted to firms (Elton and Gruber, 1970; Miller, 1977; Miller and Scholes, 1978).

The theoretical underpinning for the research in the current thesis is also based on the efficiency of the stock market as propounded by Fama (1970). In an efficient market, current prices fully and without bias reflect all published, available information. Fama (1970) categorised EMH into three types, corresponding to three different information sets: weak-form, semi-strong form and strong form. A weak-form efficient market is one in which current share prices instantly and fully reflect all past information such that an investor cannot earn excess returns by using active trading rules based on historical prices. A market is semi-strong form efficient if the current prices of securities instantly and fully reflect all publicly available information such that an investor cannot gain abnormal return either

through technical analysis or through fundamental analysis. The strong form of EMH states that current prices of securities instantly and fully reflect all information, both public and private. The current thesis tests whether the Nigerian stock market is semi-strong efficient, i.e. it examines stock market reaction to dividend announcements by companies listed in the Nigerian stock market. In this study, the share price is used as a proxy for firm value.

Accordingly, if dividend payments convey information about future performance to the market and the Nigerian stock market follows the EMH, then one would expect significant returns on the dividend announcement date. In other words, if the Nigerian stock market is efficient in the semi-strong sense, then prices will adjust immediately to the release of public information such as the announcement of earnings, dividend payments, or the proposal to merge two or more companies. Consequently, in the current thesis, any abnormal returns before the announcement date might suggest that information about dividends has leaked to the market before being officially published. On the other hand, any abnormal returns after the dividend announcement date might call the EMH into question since it would suggest that the market takes time before impounding news from the dividend into share prices.

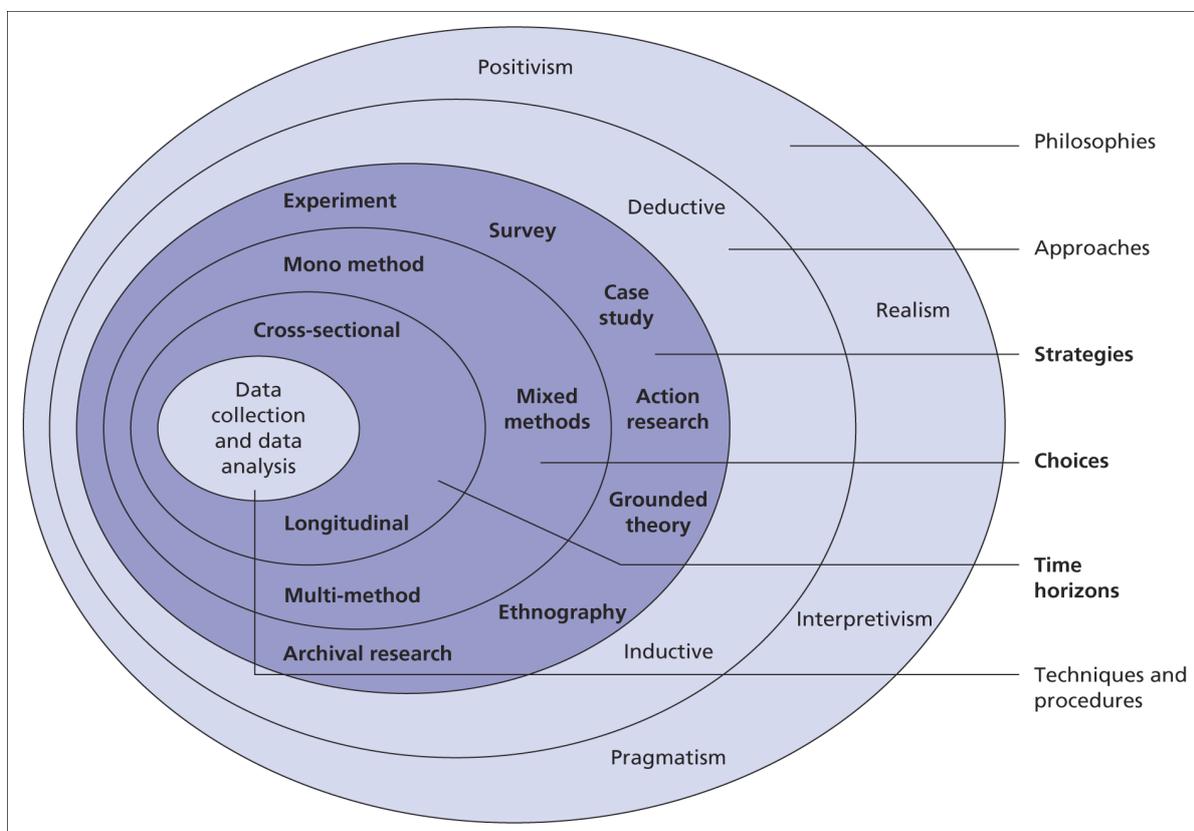
The next section discusses the philosophical assumptions about research in the social sciences. In the context of these assumptions, the rationale for employing the mixed method research design is explained and the justifications for using both the qualitative and quantitative approaches in the investigation of managerial perspectives on dividend policy and the impact of dividend announcements on share prices of companies listed on the Nigerian stock market documented in the subsequent chapters are highlighted.

4.3 Philosophical Assumptions of the Thesis

Research is the “process of finding solutions to a problem after a thorough study and analysis of situation factors” (Sekaran and Bougie, 2009, p.2). The process of researching is a series of steps designed and followed with the goal of finding answers to the issues that are of concern to the research team. Saunders *et al.* (2009) symbolised the research process as an onion, and noted that several layers of the onion need to be peeled away before reaching the central point or core of the onion- *the data collection and the data analysis.*

Figure 4.1 defines a generic research process ‘onion’ that supports the researcher to depict the issues underlying the choice of data collection methods. A visual inspection of the diagram shows that the outer layers, consisting of philosophies and approaches, and the middle layers, comprising of strategies, choices and time horizon are guiding the way towards the core of the onion and the research methodology: the techniques and procedures. This section provides justification for using the specific research philosophy, research approaches, research strategies, and data collection methods employed in the current thesis. These selections and decisions culminate in a research design.

Figure 4.1: The Research Process ‘Onion’



Source: Saunders *et al.* (2009, p.108)

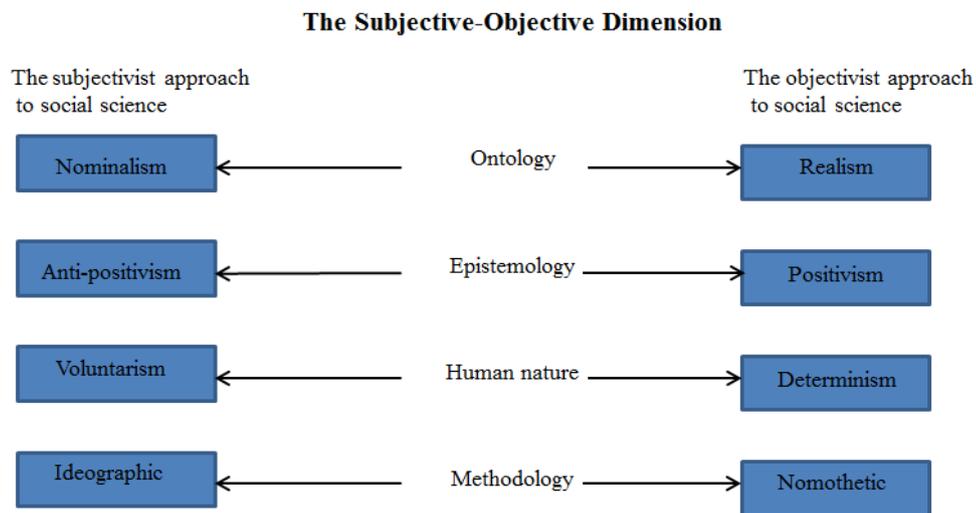
All research activities have underlying philosophical assumptions that guide the researcher. The fundamental assumption that underpins every research is known as research philosophy. Saunders *et al.* (2009) defined research philosophy as an over-arching term relating to the development of knowledge and the nature of that knowledge. To Hussey and Hussey (1997), research philosophy is the progress of scientific practice based on people’s philosophies and assumptions about the world and the nature of knowledge. Saunders *et al.*

(2009) identified the main research philosophies as positivism, interpretivism, realism, and pragmatism, and noted that the most important determinant of research philosophy is the research question and the possibility to work within positivism and interpretivism is given, as this practical approach includes various perspectives to support data gathering and interpretation.

Positivism is originated in the natural sciences and stresses the belief that social reality is singular and objective and is not affected by the investigation of it. Underpinned by precision, objectivity and rigour, casual relationships are analysed with the help of explanatory theories to understand social phenomena (Collis and Hussey, 2009). Therefore, positivism searches for regularities and relationships among the elements being investigated (Saunders *et al.*, 2009). Resulting from the criticisms of positivism, interpretivism emerged, as it concentrates on exploring social complexity with the purpose to gain interpretive understanding, while positivism is only focusing on measuring and explaining phenomena (Collis and Hussey, 2009). Furthermore, Gill and Johnson (2010) stated that the process of investigating in interpretivism affects the social reality and is subjective as well as multiple. On the other hand, as a research philosophy, realism believes in the existence of external and objective reality that influences people's social interpretations and behaviour. Realism as a research philosophy focuses on the belief that reality exists in the environment (Johnson and Christensen, 2010). Finally, Pragmatism emphasizes the practical problem experienced by people, the research questions posited, and the consequences of enquiry (Rossman and Wilson, 1985). Pragmatism draws on many ideas including "what works", using diverse approaches, and valuing both objective and subjective knowledge (Cherryholmes, 1992). It is not committed to any one system of philosophy and reality, rather researchers draw liberally from both quantitative and qualitative assumptions when they engage in research (Creswell, 2009). The pragmatic researcher is sensitive to the social, historical, and political context from which inquiry begins and considers morality, ethics, and issues of social justice to be of paramount importance throughout the research process (Cherryholmes, 1992; Morgan, 2007; Creswell, 2009). While many authors outline positivism and interpretivism as mutually exclusive and extremes, Saunders *et al* (2009), Collis and Hussey (2009) and Creswell (2009) combine these philosophies into pragmatism, which offers mixed methods research a balance of both the positivist and interpretivist

philosophies. Thus, in a mixed method research, the weakness of one philosophy can be offset with the strengths of the other.

Figure 4.2 Assumptions about the Nature of Social Science



Source: Burrell and Morgan (1979, p.3)

Developing a philosophical perspective requires that the researcher makes several core assumptions about the nature of science, which involves a choice between a subjective and an objective approach to research (Burrell and Morgan, 1979). Figure 4.2 (above) depicts the two major philosophical traditions, their respective assumptions, and the terminology associated with them. Subjectivism and objectivism have been described as a continuum's polar opposites with varying philosophical positions aligned between them. The subjective approach to social science research views entities as social constructs dependent upon the perceptions and actions of actors (human beings) performing activities in the social world (Bryman, 2008). This position holds that social phenomena are created from the perceptions and consequent actions of those social actors concerned with their existence (Bryman, 2008; Saunders *et al.*, 2009). The researchers seek to understand the world in which they live and try to develop subjective meanings of their experiences. In contrast, the objective approach to social science research maintains that entities exist in a real world external to those involved in the research (Saunders *et al.*, 2009). Objectivism assumes that social phenomena confront us with external facts that are beyond our research or influences.

Under the objective approach to social science research, organization is a tangible object consisting of rules and regulations (Bryman, 2008).

The philosophical assumptions about social science research is therefore based on a researcher's position on a subjective-objective continuum, which depends upon four assumptions about the nature of social science: ontology (reality) ontology (reality), epistemology (knowledge), human nature (pre-determined or not), and methodology (Burrell and Morgan, 1979). Saunders *et al.* (2009) defined ontology as a branch of metaphysics which deals with the nature of being and explains assumptions about reality. Thus, ontology deals with the nature of social reality and is concerned with the researchers' underlying assumptions about how the world functions. Its central question is whether social entities can, or should, be considered social constructions built-up from the perception and action of social actors. Reality may come from the external world or from internal consciousness, and it may exist independently of the researcher or it may reside in the mind of the individual (Burrell and Morgan, 1979). The researcher's view of reality is the cornerstone to all other assumptions. Reality is perceived as objective and external to the researcher by the positivist approach and subjective and internal to the researcher by the interpretivist approach. Both the subjective and objective ontological way of thinking about research philosophy influenced the process of this study, as the thesis tries to ascertain the perceptions of Nigerian corporate managers on the factors that drive dividend decision, and also to examine the impact of dividend announcements on share prices. Accordingly, the ontological position of this study does not perceive the Nigerian society as existing independently of the individuals or external to the individuals. In other words, the researcher believes in an external world independent of the mind as well as that lodged in the mind.

Epistemology can be defined as a philosophy of knowledge (Bryman, 2008). It is concerned with the nature of knowledge in terms of what form it can take and how it can be acquired and transferred (Hopper and Powell, 1985). From the perspective of subjective-objective dimension, Burrell and Morgan (1979) categorised epistemology into two aspects: positivism and anti-positivism.¹⁰ Positivism is "an epistemological position that advocates

¹⁰ Saunders *et al.* (2007) and Bryman (2008) classified epistemology into positivism and interpretivism. "Interpretivism usually denotes an alternative to the positivist orthodoxy that has held sway for decades. It is

the application of the methods of the natural sciences to the study of social reality and beyond” (Bryman, 2008, p.13). Positivism applies the models and methods of research from the natural sciences to study human nature; it searches for regularities and relationships among the elements being investigated (Saunders *et al.*, 2009). As a result, the researcher would use an extremely structured methodology to facilitate replication (Gill and Johnson, 2010). Thus, positivists believe that the researcher should be independent and distant from the research in order to give objective and measurable results. In contrast, anti-positivism is based on the analysis of the ‘frame of reference’ from the inside not from outside the researcher and those being researched. It is the product of the subjective analysis of individuals (Burrell and Morgan, 1979). Therefore, anti-positivists believe that the researcher should be immersed in the phenomena under investigation in order to obtain a thorough understanding. This thesis adopts both ‘positivism’ and ‘anti-positivism’ as its epistemological perspectives which is seen to be consistent with the research nature and its objectives. Specifically, the way in which knowledge can be attained about the dividend phenomena in the Nigerian context can come from both studying events, which by definition exists independently of the researcher or external to the perceptions of individuals, and also by considering the perceptions of individuals involved in particular activities. In the current thesis, knowledge is acquired in the first instance by searching for causal relationships between dividend announcements and share prices and secondly by considering the perspectives of the individuals who are involved in the administration of dividend policy in Nigeria.

The study of human nature focuses on whether individuals have a free will to do anything or whether their actions are constrained by rules (Burrell and Morgan, 1979). Thus, the assumptions about human nature relates to whether humans can control their environment (voluntarism) or whether they are controlled by their environment (determinism). This thesis adopts a middle point between the voluntarism-deterministic approach to human nature given the fact that a multitude of factors, such as external and socio-economic factors, may affect the dividend policy decisions of companies. The argument here does not mean that dividend policy is in the hands of external actors, rather, the dividend policy of

predicated upon the view that strategy is required that respects the differences between people and the objects of the natural sciences and therefore requires the social scientist to grasp the subjective meaning of social action” (Bryman, 2008: 16).

Nigeria listed companies is assumed to depend on the free-will of the Board of Directors. Thus, the dividend policy of Nigerian listed companies suggests that the current research question is not at either extreme of the voluntarism-determinism continuum but lies in between the two ends of the spectrum. Burrell and Morgan (1979) recommended this stance about human nature when they suggested that social science researchers may “adopt an intermediate standpoint which allows for the influence of both situational factors and voluntary factors in accounting for the activities of human beings” (Burrell and Morgan, 1979, p.6).

The assumptions which the researcher holds regarding ontology, epistemology and human nature lead to different methodologies for undertaking research (Burrell and Morgan, 1979; Hopper and Powell, 1985; Chua, 1986). Research methodology refers to the philosophical framework and the fundamental assumptions of research (van Manen, 1990). Saunders *et al.* (2009) noted that methodology is concerned with the process of doing research based on the philosophical and theoretical underpinnings of the researcher and as such, it has both ontological and epistemological dimensions. Because the philosophical framework one uses influences the procedures of research, methodology can be seen as a framework that relates to the entire process of research (Creswell and Plano Clark, 2007). Ryan *et al.* (2002) defined research methodology as the process of doing research based on the assumptions about ontology, epistemology and the view of human nature. They also noted that the selection of the most appropriate research methodology depends on the nature of the phenomenon being researched. The authors stated that:

“...the assumptions which the researcher holds regarding the nature of the phenomenon’s reality (ontology), will affect the way in which knowledge can be gained about the phenomenon (epistemology), and in turn affects the process through which research can be conducted (methodology). Consequently, the selection of an appropriate research methodology cannot be done in isolation of a consideration of the ontological and epistemological assumptions which underpin the research”.

(Ryan *et al.*, 2002, p.35).

The next section discusses the research designs in used in carryings out the research in this thesis. It identifies three research designs: qualitative, quantitative, and mixed methods. In the course of this discussion, the section explains why the research in the current thesis was

conducted within a pragmatic paradigm, which necessitated the use of mixed methods research design consisting of both qualitative and quantitative approaches to investigate the dividend policy and stock market reaction to dividend announcements in Nigeria.

4.4 Research Designs

Creswell (2009) described a research design as the plan and procedure for research that span the decisions from broad assumptions to detailed methods of data collection and analysis. Thus, research is the plan of action that links the philosophical assumptions to specific methods (Crotty, 1998; Creswell, 2003). Research design involves the intersection of philosophy, strategies of inquiry, and specific methods. Creswell (2009) identified three types of research designs: quantitative, qualitative, and mixed methods and also noted that worldviews, strategies, and the methods all contribute to a research design that tends to be quantitative, qualitative, or mixed. The author also created a distinction that may be useful in choosing an appropriate research design as presented in Table 4.1.

Quantitative research is an approach for testing objective theories by examining the relationship among variables. The final written report has a set structure consisting of an introduction, literature and theory, methods, results, and discussions (Creswell, 2008). Under the quantitative research approach, the primary investigator uses positivist claims for developing knowledge, employs strategies of inquiry such as experiments and survey, and collects data on predetermined instruments that yield statistical data (Creswell, 2003; Saunders *et al.*, 2009). Those who engage in quantitative research have assumptions about testing theories deductively, building in protections against bias, controlling for alternative explanations, and being able to generalize and replicate the findings (Creswell, 2009). The main strength of the quantitative approach lies in the use of numbers that are measurable and precise, which enable the results to be directly tested for validity and reliability using objective statistical methods which strengthen the generalizability of results. The limitation of this approach, however, is that it requires large samples which are cumbersome and expensive, and results do not have enough depth to provide a rich understanding of the phenomena (Hussey and Hussey, 1997).

In contrast, qualitative research is defined as a means for exploring and understanding the meaning individuals or groups ascribe to a social or human problem (Creswell, 2007). Collins

and Hussey (2003) noted that the qualitative approach emphasises the subjective aspects of human activity by focusing on the meaning rather than the measurement of social phenomena. Accordingly, qualitative research is associated with an interpretive philosophy. Those who engage in qualitative research support a way of looking at research that honours an inductive style, a focus on individual meaning, and the importance of rendering the complexity of a situation. In this type of research, data are typically collected in the participant's setting and analysed inductively building from particulars to general themes. Qualitative research employs strategies of inquiry such as narratives, phenomenology, ethnography, grounded theory, or case studies (Creswell, 2003) and the final written report has a flexible structure (Creswell, 2007). Even though the results of a qualitative research have enough depth to provide a rich understanding of the phenomena, this form of enquiry provides findings with reduced generalizability (Denzin and Lincoln, 2005).

On the other hand, the mixed methods research design adopts a pragmatic worldview, and involves the collection of both quantitative and qualitative data¹¹. Saunders *et al.* (2009) noted that mixed methods researchers believe that while there is an external, objective reality to the world we live, the way in which each of us interprets and understands it will be affected by our particular social conditioning. In the social sciences at large, mixed methods research has become increasingly popular and may be considered a legitimate, stand-alone research design (Greene *et al.*, 1989; Tashakkori and Teddlie, 1998; Creswell, 2002, 2003). Mixed method research is defined as “the collection or analysis of both quantitative and qualitative data in a single study in which the data are collected concurrently or sequentially, are given a priority, and involve the integration of the data at one or more stages in the process of research”(Creswell *et al.*, 2003, p.212). When quantitative and qualitative data are included in a study, researchers may enrich their results in ways that one form of data does not allow (Brewer and Hunter, 1989; Tashakkori and Teddlie, 1998). Creswell and Plano Clark (2007) noted that the mixed methods research encourages the use of multiple worldviews and is a practical and natural approach to research; the authors described mixed methods research as follows:

¹¹ Sieber (1973) noted that the concept of mixing different methods originated in 1959 when Campbell and Fisk used multi-methods to study validity of psychological traits. This prompted others to mix methods, and soon approaches associated with field methods, such as observations and interviews (qualitative data), were combined with traditional surveys (quantitative data).

“...mixed method research is a research design with philosophical assumptions as well as methods of inquiry. As a methodology, it involves philosophical assumptions that guide the direction of the collection and analysis of data and the mixture of qualitative and quantitative approaches in many phases in the research process. As a method, it focuses on collecting, analysing, and mixing both quantitative and qualitative data in a single study or series of studies. Its central premise is that the use of quantitative and qualitative approaches in combination provides a better understanding of research problems than either approach alone”.

(Creswell and Plano Clark, 2007, p. 5)

Notwithstanding the fact that quantitative and qualitative methodologies constitute alternative strategies for research, qualitative and quantitative approaches should not be viewed as polar opposites or dichotomies; instead, they represent different ends on a continuum (Chua 1986; Newman and Benz, 1998; Patton, 1990; Laughlin 1995). This suggests that quantitative and qualitative methods are not mutually exclusive. A study tends to be more quantitative than qualitative or vice versa. Creswell (2009) noted that mixed methods research resides in the middle of this continuum because it incorporates elements of both qualitative and quantitative approaches. A mixed research approach strengthens the research results because it reaps the benefits of both approaches while avoiding their limitations through what is known as triangulation (Hussey and Hussey, 1997). Triangulation is the use of different research approaches, methods and techniques in the same study to overcome the potential bias and sterility of a single-method approach. This suggests that a combination of quantitative and qualitative approaches provides a better understanding of research problems than either approach alone. Creswell and Plano Clark (2007) noted that this better understanding exists because mixed methods offer strengths that offset the weaknesses of separately applied quantitative and qualitative research methods. The authors listed the value that mixed methods research adds that quantitative or qualitative approaches, each by themselves, do not provide as follows:

- Mixed methods research provides strengths that offset the weaknesses of both quantitative and qualitative research.
- Mixed methods research provides more comprehensive evidence for studying a research problem than either quantitative or qualitative research alone.

- Mixed methods research helps answer questions that cannot be answered by qualitative or quantitative approaches alone.
- Mixed methods encourage researchers to collaborate across the sometimes adversarial relationships between quantitative and qualitative researchers.
- Mixed methods research encourages the use of multiple worldviews or paradigms rather than the typical association of certain paradigms for quantitative researchers and others for qualitative researchers.
- Mixed methods research is “practical” because it gives the researcher the freedom to use all methods possible to address a research problem and also enable individuals to solve problems using both numbers and words as well combining inductive and deductive thinking.

Against this backdrop, current thesis employs a mixed method research design, comprising of both quantitative and qualitative approaches in the investigation of the dividend puzzle in the Nigerian context. The rationales for adopting the mixed method research design in the current thesis are: (i) to extend the breadth or range of enquiry (Hanson et al., 2005); (ii) to better understand the research problem by converging numeric trends from quantitative data and specific details from qualitative data (Punch, 1998); and (iii) to obtain statistical, quantitative data and results from a sample of a population and use them to identify individuals who may expand on the results through qualitative data and results (Mertens, 2003). Thus, the mixed method research design was employed in this thesis to ensure a comprehensive investigation of the dividend policy and stock market reaction to dividend announcements in Nigeria. In the current thesis, the quantitative data comprised of close-ended questionnaire survey which seeks to identify the factors that drive the dividend decision of Nigerian companies and the event-study method which examines the causal relationships between dividend announcements and share prices. On the other hand, a semi-structured interview which seeks to ascertain the perspectives of financial managers on various dividend policy issues was used to obtain the qualitative data. The aim of the qualitative component was to probe further the responses from the questionnaire survey.

In summary, the current thesis adopts a pragmatic worldview to research in that the research question is the most important in this study. The adoption of the pragmatic paradigm necessitated the choice of a mixed methods research design, comprising of both

the quantitative and qualitative approaches in the investigation of the dividend policy and stock market reaction to dividend announcements in Nigeria. The next section provides a detailed description of each of the three research methods employed to achieve the research objectives of this thesis. These research methods include a questionnaire survey, an event study methodology employing the market model, and a semi-structured interview.

Table 4.1: Qualitative, Quantitative, and Mixed Methods Approaches

Tend to or Typically...	Qualitative Approaches	Quantitative Approaches	Mixed Methods Approaches
<ul style="list-style-type: none"> • Use these philosophical assumptions 	<ul style="list-style-type: none"> • Constructivist/ advocacy/ participatory knowledge claims 	<ul style="list-style-type: none"> • Post-positivist 	<ul style="list-style-type: none"> • Pragmatic knowledge claims
<ul style="list-style-type: none"> • Employ these strategies of inquiry 	<ul style="list-style-type: none"> • Phenomenology, grounded theory ethnography, case study, and narrative 	<ul style="list-style-type: none"> • Surveys and experiments 	<ul style="list-style-type: none"> • Sequential, Concurrent, and transformative
<ul style="list-style-type: none"> • Employ these Methods 	<ul style="list-style-type: none"> • Open-ended questions, emerging approaches, text or image data 	<ul style="list-style-type: none"> • Close-ended questions, predetermined approaches, numeric data 	<ul style="list-style-type: none"> • Both open- and closed-ended questions, both emerging and predetermined approaches, quantitative and qualitative data and analysis
<ul style="list-style-type: none"> • Use these practices of research as the researcher 	<ul style="list-style-type: none"> • Positions him- or herself • Collects participant meanings • Focuses on a single concept or phenomenon • Brings personal values into the study • Studies the context or setting of participants • Validates the accuracy of findings • Makes interpretations of the data • Creates an agenda for change or reform • Collaborates with the participants 	<ul style="list-style-type: none"> • Tests or verifies theories or explanations • Identifies variables to study • Relates variables in questions or hypotheses • Uses standards of validity and reliability • Observes and measures information numerically • Uses unbiased approaches • Employs statistical procedures 	<ul style="list-style-type: none"> • Collects both quantitative and qualitative data • Develops a rationale for mixing • Integrates the data at different stages of inquiry • Presents visual pictures of the procedures in the study • Employs the practices of both qualitative and quantitative research

Source: Creswell (2009, p.17).

4.5. Research Methods

The purpose of this section is to justify the appropriateness of the research methods employed in this thesis and the ways in which they have contributed to the achievement of the research objectives stated in chapter 1 of the thesis. Research methods refer to the ways in which research studies are designed and the procedures by which data are analysed in order to best attain the research objectives of a study. In section 4.4, the researcher explained the rationales behind the decision to employ the mixed methods research design in the current thesis. For the purpose of this research, three different techniques have been identified: questionnaire survey, event-study and semi-structured interviews.

4.5.1 The Questionnaire Survey

Survey refers to a method of data collection that utilises questionnaires or interview techniques for recording the behaviour of respondents. Ghuari and Gronhaug (2002) noted that surveys are an effective tool to get opinions, attitudes, and descriptions and investigate cause and effects relationships. The evidence using survey research methodology, such as questionnaires or interviews complements and provides a check on the purely econometric research on dividends.

The questionnaire is the most popular method of gathering information in social science research (Howard and Sharp, 1983). This popularity arises mainly from the relatively large sample of a population that can be consulted about their views on a particular issue and the ease with which a questionnaire can be distributed. A questionnaire is a means of obtaining data that are not already available in written or electronic form, or cannot be easily obtained by observation (Fair *et al.*, 2003). To de Vaus (2002), a questionnaire is a method of data collection in which respondents are asked to respond to the same set of questions in a predetermined order. Data generated through the administration of a questionnaire is referred as primary data. A questionnaire therefore provides an efficient way of collecting responses from a large sample of a population prior to quantitative analysis.

Despite the advantages of survey research, there is no prior survey research on dividend policy in Nigeria. The main line of research on dividend policy in the Nigerian equity market relies heavily on economic modelling approaches, such as the use of aggregated regression

analysis and other statistical methods in the investigation of the determinants of dividend policy. Thus, there is no understanding of how managers perceive dividends in Nigeria. Moreover, most of these studies were conducted more than 30 years ago. As chapter 2 clearly pointed out, various changes have taken place in the Nigerian investment climate since the return to democratic governance in 1999. For example, the new civilian government has removed all the unfavourable laws that hitherto limited foreign investment in the country. These changes have led to unprecedented growth in inward foreign direct investments to the country. Given this growth in inward foreign direct investments, it is worthwhile to carry out a study on the perspectives of Nigerian managers on dividend policy. Given the dearth of dividend surveys in Nigeria, the questionnaire was considered useful as an instrument for data collection in this study.

4.5.1.1 Questionnaire Design

The aim of the questionnaire survey in the current study is to investigate the factors that drive dividend decision and the relevance of dividend policy to firm value in Nigeria. Specifically, the questionnaire sought to ascertain the perceptions of Nigerian corporate managers on the: (i) factors influencing dividend policy; (ii) dividend setting process; (iii) relationship between dividend policy and firm value; and (iv) four main explanations for paying dividends. The questionnaire also sought information on the administration of dividend policy in Nigeria.

A very important and crucial step in a questionnaire survey is its design. This is because a well-designed questionnaire engages the respondents and encourages them to answer the questions honestly and accurately. A sensitive decision to make in the design of a questionnaire is the choice between open-ended (primarily qualitative) and close-ended (primarily quantitative) questions. Research methodology experts suggest using close-ended questions, because such an approach encourages respondents to reply and also helps the researcher to code the information easily for subsequent analysis (Saunders *et al.*, 2009; Sekaran and Bougie, 2009). In the current thesis, the close-ended questions was adopted to ensure the comparability of the data collected and also to allow the data to be analysed quantitatively. Other factors which influenced the choice of close-ended questions in this study is to reduce the time for data analysis and to increase the response rate, as it would

be less demanding on the time and efforts of respondents. However, four open-ended questions were included to gain additional in-depth data.

Experts in research methodology have also suggested several possible actions to be taken in order to reduce possible problems with a questionnaire and minimise any resulting bias in the research. Hiar *et al.* (2003) noted that researchers must pay attention to the length of the questionnaire as well as the manner in which the questions are structured, sequenced, and coded, in order to achieve a high response rate. In a similar vein, Dillman (1978) suggested that the questionnaire should not appear unnecessarily bulky and that sensitive questions should be avoided so that the target respondents would not ignore the document, while Jobber and O'Reilly (1996) suggested that researchers should offer incentives to respondents in order to increase the response rates. Finally, the response rates to a questionnaire can be improved by careful attention to a range of factors including questionnaire appearance, length, content, delivery methods and associated communication as well as being clearly worded and well laid out (Saunders *et al.*, 2009).

Consequently, the researcher took various issues into consideration in the design of the questionnaire for the current thesis:

- (i) The accompanying cover letter assured potential respondents' companies of their anonymities as no company details will be divulged;
- (ii) The questions were kept as short as possible and to the point to avoid errors in responses;
- (iii) The length of the questionnaire was kept to only 4 pages to ensure the document was not time consuming for the respondents;
- (iv) Ambiguous words were avoided to ensure the respondents understand the questions and answer in a clear fashion;
- (v) Sensitive questions were avoided in order to ensure that a higher response rate would be achieved;
- (vi) The questionnaire was accompanied by a stamped self-addressed return envelope to ensure that respondents do not incur any mailing expenses; and
- (vii) Incentive was offered to all respondents by way of an executive summary of the results of the study upon completion. Also, all respondents were included in a

free draw for a case of champagne if the completed questionnaires were returned by a fixed date.

The initial review of the dividend literature revealed a number of issues within the area of research. The questions included in the initial draft of the questionnaire were prepared drawing heavily upon the literature reviewed in chapter 3. Some of the original questions were adopted from previous surveys on the behavioural aspects of dividend policy conducted in the US (Baker *et al.*, 1985; Baker and Powell, 1999; Brav *et al.* (2005), in Ireland (McCluskey *et al.*, 2003), in the UK (Dhanani, 2005), in Canada (Baker *et al.*, 2008) and in the UAE (Chazi *et al.*, 2011). The final document was adjusted to reflect the Nigerian economic environment, most especially its distinctive taxation system.

4.5.1.2 Pilot of the Questionnaire Survey Instrument

Apart from taking into consideration the issues enumerated above regarding the design of the questionnaire as well as incorporating the previous literature on dividend policy, extensive consultation took place prior to the administration of the questionnaire regarding the content of the statements to be included in the questionnaire and on the overall layout of the document. A pilot study was undertaken whereby an early version of the questionnaire was administered to 12 Chief Financial Officers (CFOs) from the stock brokerage firms in Nigeria and to 8 senior academics at the Lancashire Business School of the University of Central Lancashire in April 2012. The main purpose of this pilot was to seek feedback on the clarity, validity and appropriateness of the questions and questionnaire design, and to determine the average amount of time required to complete the questionnaire (Saunders *et al.*, 2009).

Thirteen pilot questionnaires were received, out of which 12 were completed. Of the 12 completed questionnaires, 7 came from the CFOs, while the remaining 5 were from the academics. The two respondents that returned their questionnaires uncompleted indicated that they did not complete the questionnaire because it was not really relevant to their companies since they not pay dividends. Analysis of the feedback from the respondents suggested that the questionnaire was slightly too long for some respondents (especially those from the CFOs). The complexity of the questionnaire was also a little off putting to some respondents. Also, the pilot respondents confirmed that the average time taken to

complete the questionnaire was 15 minutes. Therefore, it was decided that the questionnaire structure needed to be refined and the length of some questions shortened. In the light of the feedback, the questionnaire was redesigned and various other modifications were made to the final version of the survey instrument. In addition, to ensure the validity and reliability of the responses, the re-drafted questionnaire survey instrument was also sent to the researcher's supervisory team for review before mailing it to the prospective respondents.

4.5.1.3 Administration of the Questionnaire

The questionnaire survey instrument was administered in conjunction with the NSE. This decision was taken considering the fact that the research was conducted in an emerging market where individuals are less-inclined to reply to a questionnaire due to the fear that the information provided might be misused. The researcher informed the management of the NSE about the research and sought its support to ensure the success of the research. Specifically, the Exchange allowed the inclusion of a paragraph in the covering letter referring to its support for the study. The researcher further assured the respondents of the anonymity of their companies and also promised to send them an executive summary of the results upon completion.

The final version of the questionnaire survey instrument was divided into four main sections.¹² Section 1 comprised 10 close-ended questions and one open-ended question seeking the views of the respondents on the factors that influence the dividend decision of their companies. Section 2 asked the respondents questions dealing with the dividend setting process and the relationship between dividend policy and firm value; this section included 11 close-ended questions and one open-ended question, divided into panel A and B. Section 3, which comprised 13 close-ended questions, sought the views of the respondents on the four standard theories that explain why firms pay dividends (i.e. signalling, tax preference, agency, and the bird-in-the-hand explanation). Section 4 obtained background information regarding the respondents and their companies (i.e. the most influential in developing the dividend policy of their companies, the respondent's position in the company, the company's main activity, whether the company pays a dividend or not,

¹² The questionnaire survey instrument is provided in Appendix 5.3.

etc.). The responses in section 4 facilitated the classification of the respondents into financial and non-financial firms, which enabled the researcher to examine any substantive differences in the responses between the two.

Self-completed questionnaires can be administered to the potential respondents through three different mediums: through the mail, personally administered, and electronically (internet) distributed. Considering the target population which comprise of all listed companies in Nigeria, the internet or postal questionnaires were preferable to personally administered questionnaire. However, the use of the NSE's database facilitates the use of postal questionnaires since this database contains the full postal addresses of the listed companies, but not necessarily all email addresses. Although e-mail would have been cheaper and faster to use, but sending hard copies was expected to attract more attention and thus increase the response rate. This thesis therefore employed the postal questionnaire to administer the survey document to the target respondents.

Since Nigeria has a relatively small and emerging stock market, the questionnaire was targeted at the entire population of listed companies. However, only companies that were listed on the Nigerian stock market on or before six months to the time of the distribution of the questionnaires and have their complete postal addresses at the Exchange's website were included in the sample. The questionnaires together with a covering letter requesting participation in the study were first mailed to each of the 191 companies listed on the NSE in mid-June 2012, addressed personally to the Chief Financial Officers (CFOs).¹³ The covering letter from the Institute of Global Finance and Development (IGFD) of the University of Central Lancashire on their headed paper explained the purpose of the study and urged their cooperation. The lists of the companies' addresses were obtained from the NSE's website. The second rounds of the questionnaires were mailed to the non-respondents in mid-August to reduce potential non-response bias and to increase the response rate.

4.5.2 The Event Study

This thesis also employed a standard event study methodology to examine the impact of dividend announcements on share prices of Nigerian listed firms. An event study is an

¹³ As at June 2012, a total of 191 companies were officially listed on the Nigerian Stock Exchange. This number was previously 194, but 4 companies were delisted in early 2012.

empirical investigation of the relationship between security prices and economic events (Strong, 1992). This technique of financial research enables a researcher to assess the impact of an economic event, such as takeover bid, mergers and acquisitions, earnings announcement, and a change in dividend policy on a firm's share price. According to the event study methodology, a statistically significant abnormal share return generated during the announcement period clearly indicates that the dividend announcement has not been fully anticipated and consequently, conveys important additional information to the market. Consequently, an observation of small and statistically insignificant post-announcement abnormal returns indicates that the market is information-efficient in the semi-strong sense, reacting quickly to new information releases, impounding that information into share prices rapidly and leaving no opportunity to earn above-average returns using publicly available information.

The analysis of the impact of firm-specific event on share prices requires the actual share return to be compared with the expected share return around the event announcement date in order to determine whether or not any stock market reaction has occurred. As regards dividend announcements, abnormal share returns around the event dates are estimated as the difference between the actual share returns and the expected returns that it would have earned in the event that no dividend news is disclosed. Strong (1992) noted that the actual share returns can be estimated using either a discrete or logarithmic approach¹⁴. The author also suggested two reasons why logarithmic returns are preferable:

“Theoretically logarithmic returns are more tractable when linking together sub-period returns to form returns over longer intervals (simply add up the sub-period returns) and empirically, logarithmic returns are more likely to be normally distributed and so conform to the assumptions of standard statistical techniques.”

(Strong, 1992, p. 535)

Consequently, the actual share returns for each of the companies in the sample are calculated using the logarithmic approach as follows:

$$R_{jt} = \ln (P_{jt}/P_{jt-1}) \quad [4.1]$$

¹⁴ The discrete form of share returns is calculated according to the following identity: $R_{it} = (P_{it} - P_{it-1})/P_{it-1}$.

Where; R_{jt} is the daily return of firm j on day t ; \ln is the natural log; P_{jt} is the share price of firm j on day t ; and P_{jt-1} is the share price of firm j on day $t-1$.¹⁵ Stock returns calculated from the above formula provided the total returns for the sample companies as share prices are automatically adjusted for cash dividends by the NSE on ex-dates. The daily stock market returns (returns on the market) was estimated using the NSE-ASI index (a value-weighted index)¹⁶ as follows:

$$R_m = \ln (NSE-ASI_t/NSE-ASI_{t-1}) \quad [4.2]$$

As regards the estimation of the expected returns, Strong (1992) proposed five methods of calculating expected returns: mean adjusted returns, market adjusted returns, capital asset pricing model (CAPM), the match/control portfolio benchmark, and the market model. The market model benchmark¹⁷ is the most popular method used in calculating abnormal returns in event studies. The market model assumes a linear relationship between the expected return of an individual security and the market index. There are various motivations for using the market model when estimating abnormal returns. First, the market model produces same results for samples having trading frequencies systematically different from average – infrequently or frequently (Brown and Warner, 1985). In addition, the market model produces “smaller variance of abnormal returns and smaller correlations across security abnormal returns given closer conformity to standard statistical tests” (Strong, 1992, p. 538). Moreover, the market model will automatically control for size effect (Schwert, 1983). As a result, the present study calculates the expected return using the following market model:

$$E(R_{jt}) = \alpha_j + \beta_j R_{mt} + e_{jt} \quad [4.3]$$

¹⁵ Black and Scholes (1974) noted that share returns can be estimated as dividend plus capital gain instead of only in terms of share price, i.e. $R_{it} = \ln (P_{it} + D_{it}) / P_{it-1}$, where D_{it} is the dividend amount for the current year. However, in calculating returns according to equation [4.1] dividends were not included for two reasons: (i) because of non-availability of reliable dividend amounts; and (ii) this method of calculating share prices was adopted to maintain comparability with other studies in the area e.g. Lonie et al (1996) and McCluskey et al. (2006).

¹⁶ In this study, the NSE-ASI index is constructed on the basis of a value-weighted index. This index was adopted in this study as there is “no evidence that the use of the value-weighted index increases the power of the tests” compared to equally-weighted index (Brown and Warner, 1980, p. 248).

¹⁷ Brown and Warner (1985) recommend the use of the market model under a variety of conditions when using daily returns. In addition, prior studies such as Petit (1972), Aharony and Swary (1980); Easton (1991), Lonie et al. (1996), McCluskey et al. (2006), Al-Yahyaee et al. (2011) used the market model in the estimation of the expected returns.

Where:

R_{jt} = actual returns on stock j on day t ,

α_j, β_j = the intercept and slope, respectively, of the linear relationship between the return for stock share j and the returns of the NSE,

R_{mt} = return on the NSE index on day t , and

e_{jt} = error term of stock j at period t and is expected to have a value of zero.

The abnormal return (AR_{jt}) for stock j on day t is then estimated by subtracting the actual return on day t from the expected return predicted from the market model:

$$AR_{jt} = R_{jt} - (\alpha_j + \beta_j R_{mt}) \quad [4.4]$$

Where; AR_{jt} is the abnormal return on stock j on day t , R_{jt} is the expected return on stock j on day t (obtained from the market model), and R_{mt} is the return on the market portfolio, which was proxy for in this study by the NSE-ASI index. For the purpose of this study, the coefficients α and β are ordinary least squares (OLS) estimates of α_j and β_j estimated from a regression of daily stock returns on daily market returns over a 120 trading day period prior to the dividend announcement date (D_{t-131} to D_{t-11}). Researchers have employed various estimation periods in the literature for calculating the market model parameters using the OLS. For example, Lonie *et al.* (1996) and McCluskey *et al.* (2006) used 180 days for dividend studies, while Amihud and Murgia (1997) and Dharmarathne (2013) included 120 observations in their estimation procedure. In a study by Al-Yahyaee *et al.* (2011), the market model was estimated over a 210 days centred on the dividend announcement day. According to Strong (1992), there is a trade-off between increasing the number of observations to improve the statistical accuracy of the estimated α_i and β_i and not going too far back from the test period in case the parameters of the model change across time. This factor influenced the decision to include 120 observations in the estimation of the market model in the present study.

The daily average abnormal return for day t is calculated as follows:

$$\overline{AR}_t = \sum_{j=1}^n \frac{AR_{jt}}{N} , \quad [4.5]$$

Where AR_{jt} = the weighted average portfolio abnormal return for dividend-increasing firms, dividend-decreasing firms, and for dividend no-change firms, N is the number of events in the sample.

The cumulative average abnormal return in the days surrounding the dividend announcement dates is calculated by summing average ARs over time as follows:

$$CAR_t = \sum_{t=K}^L \overline{AR}_t \quad [4.6]$$

Where; CAR_{jt} is for the period from $t = K$ days, until $t = L$ days.

In terms of the measurement interval, the daily share price data were used to detect the presence or absence of abnormal share performance in a 21-day event window, measured from day - 10 to day +10 surrounding the dividend announcement date. The daily return data was favoured to their weekly or monthly counterparts because daily returns data allow the impact of dividend news to be isolated, thereby diminishing the probability of contamination from other signals (Dyckman *et al.*, 1984; Morse, 1984; Brown and Warner, 1985). However, there are few problems associated with daily share prices. First, daily security returns exhibit statistical problems such as deviation from normality¹⁸ and autocorrelation as compared to their weekly or monthly counterparts. In addition, there is a higher risk of bias and inconsistency in estimating model parameters when daily data are used. Although daily data deviates from normality, the mean abnormal returns on a large sample of shares converges on normality, enabling the researcher to use Ordinary Least Square (OLS) and t-statistics with a reasonable degree of confidence (Brown and Warner, 1985).

Some researchers have suggested that share betas (β s) vary dramatically over time. For example, Blume (1975) identified the problem of instability in beta estimates, which arises from errors in both equations and in variables. This is supported by a number of event studies which examined aspects of market overreaction and documented evidence that

¹⁸ Brown and Warner (1985, p.25) noted that “the non-normality of daily returns has no obvious impact on event study methodologies”.

beta can alter dramatically between successive test periods (Chan, 1988; Ball and Kothari, 1982). Strong (1992) also noted that numerous event studies have documented that the explanatory power of the market model regression equations and the mean cross-sectional value of beta rise as the measurement interval increases. Moreover, serious bias arises where beta estimates are calculated for shares that are infrequently traded (Dimson, 1979). The author documented evidence that the estimated betas of infrequently traded UK shares rise as the interval increases, while to a lesser extent, the opposite holds for the frequently traded shares. The above analysis suggests that infrequently traded shares have a beta estimate which is biased downwards, while the measure for frequently traded share is biased upwards. However, thin trading effects on beta estimates can be corrected using the following suggestions proposed in the literature. Scholes and Williams' (1977) suggested a beta estimator which assumes a simple regression of the return on the security against the return on the market. Thin trading effects on bet estimates can also be corrected by using an aggregate coefficient estimator, which does not require that a trade occurs in every return interval and also by running multiple regressions of share returns against lagged, matching and leading values of the market index (Dimson, 1979).

An important characteristic of an emerging market such as Nigeria is the existence of thin trading problems, where corporate information is often neither reliable nor available to all traders. As a robustness check and to test the sensitivity of the results of this study to beta estimation, an alternative approach to calculating the abnormal return was employed following Charest (1978), Woolridge (1982), and Al-Yahyaee *et al.* (2011). Specifically, abnormal returns were generated on the assumption that the abnormal return for a firm's share was equal to the market return as proxy by the NSE-ASI index. Therefore, abnormal returns were also calculated as the difference between the actual return earned by a stock on a particular day and the return on the market for the same day. Using this approach, stocks is assumed to have a beta of 1.0. The abnormal returns were calculated as follows:

$$AR_{jt} = R_{jt} - R_{mt} \quad [4.7]$$

Where; AR_{jt} is the abnormal return of stock j on time t , R_{jt} is the actual return of stock j on time t and R_{mt} is the return on the market index on time t .

For the purpose of this study, day t_0 is designated as the dividend announcement date, where t is defined as the occasion of the very first official statement on dividends that can be identified in press releases such as nationally circulated financial papers or other databases (Gurgul *et al.*, 2003). According to the signalling hypothesis, if changes in dividends convey information, the abnormal return earned on the dividend announcement date should be significantly different from zero (Lonie *et al.*, 1996; McCluskey *et al.*, 2006). The abnormal returns which are significantly different from zero indicate the prominent market reaction to the information conveyed by the announcement of dividends. For the purpose of testing the “information content” hypothesis of dividend announcements, the dividend announcement news was divided into three main categories based on the character of their changes in the dividend level: (i) dividend-increasing companies (DI); (ii) dividend-decreasing companies (DD); and (iii) dividend-no-change companies (DnC). The signalling hypothesis predicts that the shares of dividend-increasing companies should, on average, earn positive abnormal returns, and the shares of dividend-decreasing companies should, on average, earn negative abnormal returns, while the shares of dividend-no change companies should, on average, earn normal returns (zero abnormal returns).

Numerous studies conducted on the impact of dividend announcements on share prices in developed capital markets have documented that the dividend news is not conveyed to investors in isolation; rather dividend disclosure is usually accompanied by the announcement of company earnings and other events that may generate a certain amount of market noise (Kane *et al.*, 1984; Easton, 1991; Lonie *et al.*, 1996; McCluskey *et al.*, 2006).¹⁹ In Nigeria, both dividends and earnings are announced at the same time, usually during the financial-year end for companies listed on the NSE. As Chapter 3 highlighted, the occurrence of such confounding events around firm-specific announcements is a problem for event studies in general. This contemporaneous release of both dividends and earnings news requires the interaction between dividend and earnings to be analysed in order to observe the influence of the two signals on share values. Disentangling the importance of the dividend component of the joint signal may be problematic (Kane *et al.*, 1984; Easton, 1991; Lonie *et al.*, 1996, McCluskey *et al.*, 2006). In an attempt to disentangle these

¹⁹ One of the few studies that analysed the isolated announcements of dividends and earnings was a US study by Aharony and Swary (1980), which identified 149 firms that made no earnings announcements for 10 days before and after the dividend announcements.

confounding signals, prior studies have applied two measures: (i) examining the abnormal returns for different dividend-earnings groups and (ii) employing regression analysis to analyse the interaction between dividends and earnings news. In Nigeria, both dividend and earnings are announced concurrently to the market. This may create problem when attempting to study the impact of dividend announcements in the market without considering any confounding earnings signal. However, in the current study, the researcher did not analyse this interaction effect because of the non-availability of reliable earnings per share (EPS) data of the sample companies.

In summary, the purpose of the standard event study methodology employed in this thesis was to investigate how the Nigerian stock market reacts to cash dividend announcements in order to determine whether or not dividends convey price-sensitive information to the market. Specifically, the study tests the null hypothesis that the daily average abnormal return is zero. In other words, cash dividend announcements have no systematic impact on corresponding share prices. This hypothesis was tested by performing a parametric t-test where the t-statistics are calculated using the cross-sectional standard deviation. In the current thesis, both the market model and the market adjusted returns were employed in the calculation of the abnormal returns. This objective was accomplished by employing data from all the companies listed on the Nigerian stock market that announced cash dividends between January 1, 2008 and December 31, 2012. Chapter 6 of this thesis reports the findings of this part of the study.

4.5.3. The Interviews

The thesis also employed the interview method to investigate the field practice of dividend policy in Nigeria. Interviews were used as the final piece of work in this thesis in order to capture other themes that required further discussion and understanding from the questionnaire survey. An interview is an interaction between an interviewer and interviewee(s) through face-to-face, telephone or computer dialogue (Hair *et al.*, 2003). Interviews are a good source of data collection about organisational cultures of different firms operating in various industries because it provides good insights about interviewee's attitude, opinions, values, experiences, background and practices (May, 2005). Therefore,

interviews introduce depth and validity into the findings while studying from within the culture of the interviewees (Hussey and Hussey, 1997; Neuman, 2000).

Interviews vary from being highly unstructured to highly structured. Generally, three types of interviews exist: structured, unstructured, and semi-structured (Hair *et al.*, 2003; Saunders *et al.*, 2009; Sekaran and Bougie, 2009). For a structured interview, the interviewer employs an interview sequence with predetermined questions (Hair *et al.*, 2003), and it is conducted when it is known at the outset what information is needed (Sekaran and Bougie, 2009). The objective of a structured interview is to ensure that interviewees' replies can be aggregated, and this can be achieved reliably only if those replies are in response to identical clues (Bryman and Bell, 2007). This standardized approach ensures responses are comparable between interviews using statistical techniques. However, the disadvantage of structured interviews is that they are not flexible, and as a result, the information obtained is limited and predetermined (Cameron and Price, 2009).

In contrast, an unstructured interview is conducted without the use of an interview sequence or planned sequence of questions (Hair *et al.*, 2003). The goal of this style of interviewing is to bring some preliminary issues to the surface so that the researcher can determine what variables need further in-depth investigation (Sekaran and Bougie, 2009). Although unstructured interviews ensure flexibility and openness to the issues being discussed, its disadvantage lies in the potential for interviewer selectivity and influence and low comparability (Cameron and Price, 2009). On the other hand, a semi-structured interview lies between unstructured and structured interviews, and is a widely used practical business research method (Cameron and Price, 2009). This approach has an overall structure and direction, but allows a lot of flexibility to include unstructured questioning (Hair *et al.*, 2003). Therefore, semi-structured interviews results in unexpected and insightful information coming to light, thus enhancing the findings of a study.

In this thesis, the semi-structured interview is used as the method to gather in-depth qualitative data about the dividend decisions of Nigerian companies. This approach is preferred to 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). Interviews remained flexible so as to encourage respondents to discuss the factors that drive their firms' dividend decisions and the relevance of dividend policy to firm value in Nigeria. Although questions were prepared in advance to guide the researcher to focus on the particular areas of interest, the semi-structured approach provides more flexibility as it allows the interviewees to respond to questions in a manner which they believe to be most appropriate. In addition, it also permits the interviewer to clarify any ambiguity in the answers that arise during the interview process (Ryan *et al.*, 2002; Bryman, 2004). Finally, the dearth of prior studies of managerial perspectives on dividend policy in Nigeria also influenced the decision to use the semi-structured approach, which offers the interviewer the opportunity to identify non-verbal clues such as tone of voice and facial expressions that can be used to develop follow-up questions.

The process of interviewing, whether in a structured, semi-structured or unstructured interviews, can take a variety of forms including face-to-face, telephone, or electronically via computer dialogue (Hair *et al.*, 2003). The face-to-face interviews involve direct contact with the interviewees, while the telephone interviews are not face-to-face, but still can be very effective. On the other hand, computer dialogue involves the answering of questions online through the use of personal computers (PCs). This could be in the form of online interviews or, in its simplest form, an emailed questionnaire that facilitates discussion on a one-to-one basis or by a group (Hair *et al.*, 2003). The face-to-face interviews were adopted in this study, as this approach helped the researcher to develop rapport with the interviewees, which facilitated a comfortable communicative relationship with the interviewees (Quinlan, 2011). In addition, it enables the interviewer to record the context of the interview and non-verbal gestures of the respondents (May, 2011). Moreover, the face-to-face approach also enables the researcher to adapt the questions as necessary, clarify doubts, and ensure that responses are properly understood, by repeating or rephrasing the questions (Sekaran and Bougie, 2009). Finally, the face-to-face interviews were used in this study in order to allay any fears on the part of the respondents regarding the motives behind the interview since this research was conducted in an emerging market characterised by fear of abuse of information.

In this study, the semi-structured interview document used to guide the interviews was designed based on the constructs from previous theoretical and empirical literature review, including studies by Lintner (1956), Baker *et al.* (1985), Brav *et al.*, (2005), McCluskey *et al.*, (2007), Baker *et al.*, (2008), Chazi *et al.*, (2011) and Khan *et al.*, (2011). The interview guide used in this thesis was open-ended in order to help broaden the range of problems discussed by the researcher, and also ensure flexibility by allowing the interviewer to make a truer assessment of what the respondents really believes (Cohen and Manion, 1989). These advantages make the open-ended questions the preferred type of questions in all kinds of interviews. Moreover, having employed close-ended questions in the questionnaire survey which was assessed to be potentially limiting, it was decided that in order to off-set this drawback an open-ended questions should be used at the interview stage. Above all, it was expected that the targeted financial managers would be more helpful and unbiased if they were given the opportunity to freely express their views and opinions.

4.5.3.1 Pilot Interviews

As indicated earlier, the interview guide for this study was formulated based on the constructs of previous theoretical and empirical literature on dividend policy. Given the nature of the questions, which was basically semi-structured, there was need to pilot the interview document before embarking on the interview itself. Wengraf (2001) emphasised the importance of piloting the data-collection instruments in the context of qualitative studies. The author argued that since semi-structured interviews are based on the premise of the interviewer guiding the interviewee through the interviews, it was important to make sure that the questions did not change too much during the implementation of the interview stage. This means that that the questions had to be refined during the pilot, so that they could remain unaltered during the main interview stage.

In the present study, the initial version of the interview guide was first formulated and presented to my supervisory team and other senior academics at the Lancashire Business School for feedback on the appropriateness of the questions. Based on their comments and opinions, the semi-structured document was later revised and many of their suggestions incorporated. The researcher then piloted the interview document by conducting interviews with four corporate managers in Nigeria (not from the sample set selected for the main

interviews) to investigate their perspectives on various dividend policy issues. The pilot interviews were conducted via telephones in October 2012 and lasted for about 90 minutes to 1 hour 45 minutes. The researcher made further changes to the format of the questions with the goal of reducing the time needed to complete the interview.

In summary, the purpose of the pilot interview in this study was to test and further develop the instrument for the main interview. The pilot interviews provided further insight into the appropriateness of the research questions, and the feasibility of the planned research timeline. This enabled a resolution of the likely challenges to the main interview. Overall, the pilot interviews helped improve the professionalism of the interviewer.

4.5.3.2 Sample Selection for the main interview

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). These firms were not randomly chosen because of the need to obtain cross-sectional differences in firm characteristics and dividend policy practices. Specifically, the analysis of the findings from the questionnaire survey informed the choice of companies selected for the follow-up interviews. The sample was also based on the availability of respondents. The 21 financial managers selected for the interviews were drawn from the 68 companies that completed and returned their questionnaire survey conducted in mid-June 2012. This decision was taken for two reasons: (i) to enable the researcher probe further the responses obtained in the questionnaire survey that required further discussion and understanding; and (ii) for easy access into the companies having established a good rapport with the managers.

The interviews were designed to add a modern dimension to the understanding of dividend policy. In the spirit of Lintner (1956), the interviews targeted firms in different industries and with different payout policies. In particular, the interviews targeted both financial and non-financial firms in order to provide any substantive differences in attitudes to dividend policy between the two, in terms of the factors that drive the dividend decisions, the dividend payout ratio, as well as the signalling theory of dividend policy. The sample companies are

drawn from nine different sectors of the Nigerian economy.²⁰ Out of the 21 companies selected for the interviews, eight are financial firms while thirteen are non-financial firms. Such sample was considered useful to allow for comparisons of findings between financial and non-financial firms.

4.5.3.3 The Interview Process

The interview process started with preliminary contacts to obtain agreements to participate in the research, and the identification of suitable personnel. When seeking access into the companies, the researcher 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. This process was intended to ensure that the respondents share information without fear that such information will be misused by the researcher. Telephone calls were also made to all the respondents, during which the researcher re-assured the interviewees that the identity of their firms and that of their executives would remain anonymous. After the confirmation of acceptance to take part in the interview, the researcher contacted all potential respondents via the telephone to schedule a convenient date, time and venue for each interview. Through this process, the researcher and the interviewees reached an agreed upon dates for the interview. The interviewees were also reminded of the need that the interview be tape recorded. However, the researcher assured the interviewees that, in case they are not comfortable with the tape, the recording may not take place.

In the current study, a semi-structured interview guide was used to guide the interviews.²¹ The financial managers were asked about the factors that craft the dividend policy decision of the companies and the signalling effect of dividend policy. Specifically, the interviews focused on the following dividend policy issues: (i) factors that drive dividend decision; (ii) dividend conservatism; (iii) target payout ratio; (iv) residual dividend policy; (v) dividend signalling; and (vi) taxation. All the respondents were provided with a copy of the semi-structured interview guide to give them an overview of the topic that is likely to be

²⁰ These sectors include agriculture, food and beverages, oil and gas, consumer goods, healthcare, financial services, ICT, industrial goods and construction and real estate.

²¹ The semi-structured interview document is provided in Appendix 7.2.

discussed during the interview. The issues covered in the semi-structured interview were based on careful examination of the literature and the results of the questionnaire survey conducted in mid-June 2012.

Prior to the commencement of each interview, the researcher perused the internet to gain some background information about the nature of the organisation and their financial health.²² This process helped the researcher to develop rapport with the interviewees. Before the start of each interview, the interviewees were assured that the interview did not require any theoretical or academic understanding of dividend policy, but dealt instead with the practises of dividend policy in their respective companies. Finally, the researcher also re-assured the interviewees that their identities and those of their companies would remain confidential. This approach helped to allay any fears of the respondents about the misuse of the information and also the motives of the researcher.

The interviews took place between December 2012 and March 2013 at the headquarters of the selected companies at Lagos, Nigeria. Interviews were conducted with 21 financial managers who are directly involved in the administration of dividend policy in their respective companies. 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. The interviews lasted for about 1 hour to 1 hour 15 minutes in duration, and for each company, only one individual was interviewed.

4.5.3.4 The Post-Interview Process

The researcher recorded the information from the interviews by making hand-written notes and by audiotaping in some cases where the interviewees gave their consent as suggested by Creswell (2009). The transcription of the tape was done immediately the researcher returned to his hotel suite.²³ The researcher assigned every interviewee a unique code (C1-C21) for ease of reference, and also to maintain the anonymity of the respondents as well as to protect the identity of the respondents' companies. The researcher listened to the

²² This information was obtained from the Nigerian Stock Exchange (NSE) official website.

²³ The process of data analysis for some of the interviews where no tape recording took place was similar except that those steps involving listening to tapes were omitted.

transcripts and made comparison with the notes taken during and after each interview. All transcripts together with the notes taken at each meeting were then scrutinised to ensure complete knowledge of the data. A further reading of all transcripts was undertaken by the researcher after two days of each interview, in order to ascertain if any new perspectives or apparent contradictions in the replies from the interviewees on specific issues could be established. All the additional issues identified were documented at the relevant section of the interview guide for each of the interviewee. This second reading facilitated the preparation of detailed data summaries that highlighted emerging core views on various dividend issues amongst interviewees.

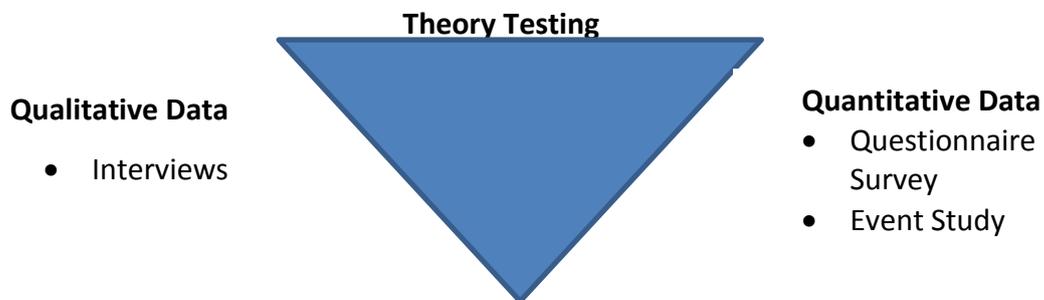
After the second reading of all transcripts, the researcher adopted the suggestion by Miles and Huberman (1994) by preparing simple manuscript matrices summarising the essential replies identified in each interview in order to highlight the core findings. Miles and Huberman (1994) noted that matrix presentations facilitate the identification of predominant views and patterns in the interview data and assist the research process by distinguishing the relative incidence of different perspectives. This process enabled the researcher to determine the predominant views emerging from the data and also sustained the search for the identification of apparent contradictions in the predominant views emanating from the data. Although the matrices were excessively detailed initially, they were reduced gradually, systematically and progressively into essential findings, by splitting the interview data according to the four potentially influential categories (i.e. factors that drive dividend decision, dividend conservatism, target payout ratio, residual dividend policy, dividend signalling, and taxation). This process provided the first draft of the results of this study.

4.6 Triangulation of Data

Triangulation has been defined as the use of different research approaches, methods and techniques in the same study to overcome the potential bias and sterility of a single-method approach (Hussey and Hussey, 1997). Some authors view triangulation as a methodological pluralism that enables the researcher to use different techniques to get access to different facets of the same social phenomenon (Sayer, 2000; Carter, 2003). Saunders *et al.* (2009) noted that a multi-method approach can often be beneficial, combining quantitative and

qualitative data, and primary and secondary data. This allows “triangulation” whereby collecting data from different sources allows verification of the information collected. Triangulation involves the conscious combination of quantitative and qualitative methodologies as a powerful solution to strengthen a research design where the logic is based on the fact that a single method can never adequately solve the problem of rival causal factors (Denzin, 1978; Patton, 1990; De Vos, 1998). Miller and Fiesen (1982) argued that triangulation enables concerns raised by the use of either quantitative or qualitative data to be dispelled. Figure 4.3 illustrates the use of triangulation of data sources in this thesis:

Figure 4.3 Triangulation of data



In the social sciences, the use of triangulation can be traced back to Campbell and Fiske (1959) who developed the idea of “multiple operationism”. They argued that more than one method can should be used in the validation process to ensure that the variance reflected that of the trait and not of the method. There are two types of triangulation in the literature: data triangulation and methodological triangulation. Data triangulation involves the cross-checking of the consistency of specific and factual data items from various sources via multiple methods at different times (Guber and Lincoln, 1989; Patton, 1990). In other words, data triangulation entails the collection of data in different time frames or from different sources. On the other hand, methodological triangulation entails combining both quantitative and qualitative data collection methods (Bannister *et al.*, 1994).

In the current thesis, both data triangulation and methodological triangulation were employed in the investigation of the dividend and stock market reaction to dividend announcements in Nigeria. Data triangulation was used by comparing the information from

different sources such as questionnaire and interviews. The interviews were basically designed to probe further the responses from the questionnaire survey. On the other hand, methodological triangulation was employed through the use of both quantitative and qualitative approaches. In the quantitative approach, the study used the questionnaire survey of corporate managers' perspectives on dividend policy and the capital market-based event study that examines the impact of dividend announcements on share prices. Qualitative approach was adopted in the literature review and interviews with financial managers about their views on dividend policy. This process of triangulation improves the credibility of the data collection process.

4.7 Conclusion

This chapter discussed the research methodology and methods that were employed in carrying out the research in this thesis. The chapter noted that the philosophical paradigm believed by individual researchers will determine whether researchers will embrace a qualitative, quantitative or mixed methods research design (Creswell, 2009). It also identified the philosophical assumptions underpinning research in the research in the current thesis. In the context of these assumptions, it explains the reason behind the adoption of the pragmatic worldview and the use of mixed methods research approach, consisting of both the quantitative and qualitative approaches in the investigation of the dividend policy and stock market reaction to dividend announcements in Nigeria documented in subsequent chapters of this thesis.

Furthermore, the chapter noted that since the study employed both the quantitative and qualitative research methods, the researcher does not adopt the extreme positions with regard to the ontological and epistemological assumptions underpinning the work (Chua, 1986; Laughlin, 1995). The approach adopted in this thesis recognises the importance of investigating the reality of the social world in the process of intellectual discovery and also acknowledges the possibility of amendment and refinement during the conduct of the empirical work to take account of changed circumstances in view of experience.

In summary, the current thesis adopts a mixed method research design, involving both the quantitative and qualitative approaches. In particular, three different research methods

were employed to investigate the dividend puzzle in the Nigerian context: questionnaire survey, an event study and semi-structured interview. On the quantitative side, a questionnaire survey was used to investigate the determinants of dividend policy and a standard event study method based on the market model was employed to examine the relationship between dividend announcements and share prices. On the other hand, a qualitative approach was adopted in the semi-structured interviews, which sought the views of selected financial managers on various dividend policy issues. The results from these studies are documented in chapters 5, 6 and 7 of this thesis.

CHAPTER FIVE

NIGERIAN CORPORATE MANAGERS' PERSPECTIVES ON DIVIDEND POLICY

5.1 Introduction

This chapter investigates the perspectives of corporate managers on the factors that drive dividend decision and the relevance of dividend policy to firm value, using a postal questionnaire survey addressed to the CFOs of each of the 191 companies listed on the Nigerian Stock Exchange (NSE) as at mid-June 2012. The main objective of this survey is to ascertain whether Nigerian corporate managers believe that dividend policy is relevant to corporate valuation. More specifically, the questionnaire seeks the views of corporate managers on four main topics: (i) the factors that influence the dividend decision of their companies; (ii) how companies set the amount of dividends they pay to shareholders; (iii) the relationship between dividend policy and firm value; and (iv) explanations of dividend relevance including the signalling, tax preference, agency theory, and the bird-in-the-hand explanations. The study also evaluates the extent to which managerial views on these issues differ between financial and non-financial firms.

The current study on management perceptions about dividend policy is important for two reasons. First, the study provides new evidence on the factors that drive dividend decision from the perspective of a developing country, such as Nigeria. To the best of the researcher's knowledge, there is no prior survey on the dividend behaviour of management applied to the Nigerian context. Thus, this study is the first comprehensive survey of managerial perspectives on dividend policy applied to the Nigerian context. Second, this study updates and extends the results of prior studies on industry-related dividend effect, by comparing the managerial perspectives on dividend policy for Nigerian financial and non-financial firms. To date, there is mixed evidence on the impact of industry classification on dividend policy. For example, while some studies document an industry influence on dividend policy (Baker *et al.*, 1985; Baker, 1988; Barclay *et al.*, 1995; Baker *et al.*, 2001; Baker *et al.* 2008), others found weak or no support for an industry-related dividend effect (Howe and Shen, 1988; Dempsey *et al.*, 1993; Frankfurter and Wood, 2003).

The remainder of this chapter is divided into five main sections. Section 5.2 sets out an analysis of the respondent firms' profile while section 5.3 provides a test of non-response

bias. Sections 5.4 presents the research findings and compare these findings with the results of prior studies on dividend behaviour of management. Section 5.5 discusses the administration of dividend policy in the sampled firms. Finally, section 5.6 summarises the main conclusions.

5.2 Descriptive Statistics of Sample Firms

The questionnaire survey generated a total of 68 usable responses (from the 191 mailed), consisting of 46 responses from the first mailings and 22 responses from the second mailings. This is equivalent to a 35.6 per cent response rate. Of the remaining questionnaires, 35 questionnaires were returned uncompleted, while 88 failed to acknowledge receipt. A summary of the reasons given for non-completion is shown in table 5.1. The most popular reason appeared to be time constraints, followed by a company policy not to participate in questionnaire surveys. Other reasons adduced for non-completion of the questionnaire include that their firms do not pay dividends or that the CFO is away on business purposes. Only 2 questionnaires were returned marked ‘wrongly addressed’, indicating that the process of verifying the company addresses via telephone was successful.

Table 5.1: Reasons provided for non-completion of questionnaires

Reason for non-completion	Number of companies	Percentage of companies
No time/too busy	17	48.57
Company policy	8	22.86
Company do not pay dividends	5	14.29
CFO away on business	3	08.57
Wrongly addressed	2	05.71
Total	35	100

Source: Survey 2012

Given the fact that the return rates of mail questionnaires are relatively low (Saunders *et al.*, 2009; Sekaran and Bougie, 2009; Creswell, 2011; Robson, 2011), the usable response rate of the present study (i.e. 35.6 per cent) is exceptionally a good rate for studies of this sort. In the research methodology literature, there is no consensus on what type of response rate is “proper” or “satisfactory”. For example, while Saunders *et al.* (2009) suggested that a 20%

response rate is acceptable, Sekaran and Bougie (2009) submitted that a response rate of up to 30% is adequate. Furthermore, the response rate of the current study is substantially higher than the rate achieved by some recent survey studies on dividend policy. In a recent survey on dividend policy, McCluskey *et al.* (2003) obtained 26.9% usable response rate for Irish companies, while Dhanani (2005) achieved 25.1% response rate for companies in the UK. More recently, Chazi *et al.* (2011) obtained 34.6% response rate in a dividend survey applied to companies in the United Arab Emirates (UAE). Therefore, as regards the response rate of the current study, it satisfies the average proposed in the research methodology literature and is above the response rate of prior surveys on dividend policy.

Table 5.2 presents the descriptive statistics of the sampled firms. An analysis of this table shows that there is wide dispersion of the responding Nigerian firms among various industry classifications. In all, nine industries were represented including, “Financial Services”²⁴ sector which accounted for the highest numbers of respondents (23 respondents) while the “Food and Beverages” and “Agriculture” sectors were next with 12 and 10 respondents respectively. The “Consumer Goods” sector provided 6 respondents while the “Healthcare” sector accounted for 5 respondents. The “ICT” sector accounted for 4 respondents while both the “Industrial Goods” and “Oil & Gas” sectors provided 3 respondents each. The “Construction/Real Estate” sector provided the lowest valid responses with 2 respondents. Thus, the sample of this study is comprised of 23 financial firms representing 33.8 per cent of the usable responses and 45 non-financial firms representing 66.2 per cent of the usable responses. Overall, the range of sectors represented in the sample suggests that the results of this study are based on responses by firms from various sectors of the Nigerian economy.

With respect to dividend-paying status of the sampled firms, 50 (73.5 per cent) are dividend-paying firms while 18 (26.5 per cent) are non-dividend-paying firms. This result shows the importance Nigerian firms attach to dividend payments as more than 70 per cent of the responding firms are dividend payers. This result is not surprising given the subject of the survey, it was expected that majority of the respondents to the survey would come from the dividend-paying companies. Furthermore, this survey targeted the managers of listed firms and as such it is expected that listed firms will be more willing to pay dividends since

²⁴ The financial services sector comprises of firms operating in the banking, finance, insurance and real estate.

they do not have any other means to transmit information like their privately-held counterparts. The finance literature suggests that managers of listed firms are more likely to use dividends to signal their financial strength to both current and potential investors. The responding dividend-paying firms were also categorised on the basis of change in the level of dividends paid. Of the 50 dividend-paying firms, 36 representing 72 per cent have recently changed their dividend levels while 14 (28 per cent) did not. This result is hardly surprising in that that listed companies often increase or decrease their dividends to reflect the level of their current earnings.

Table 5.2: Descriptive Statistics for Sampled Firms

Sector	Total	Dividend paying	Non-dividend paying	Dividend changed	Dividend unchanged
Financial services	23	18	5	16	2
Food and Beverages	12	9	3	6	3
Agriculture	10	8	2	7	1
Healthcare	5	3	2	1	2
Consumer goods	6	5	1	2	3
ICT	4	2	2	0	2
Oil & gas	3	2	1	2	0
Industrial goods	3	2	1	1	1
Construction/real estate	2	1	1	1	0
Total	68	50	18	36	14

This table provides descriptive statistics for the 68 responding firms on two key characteristics. The dividend-paying/non-dividend paying characteristics were determined by responses to the question: 'Does your company pay an annual dividend to shareholders?', while the dividend changed/dividend unchanged characteristic was determined by responses to the question: 'Has the level of dividend changed recently?'

The survey also sought information on the status of the individuals that completed the questionnaire. A critical examination of the respondents' profiles suggests that knowledgeable individuals involved in the determination of their companies' dividend policy completed the questionnaires, which, in turn, lends credibility to the results of this survey. As Table 5.3 shows, the majority of the survey respondents (52.9 per cent) hold the position of the CFOs, for whom the questionnaire was targeted at. This was closely followed by the Chief Executive Officers (CEOs) with 17 respondents representing 25.0 per cent of the usable response rate. The remainder appeared to hold senior corporate positions, such as

finance director (10.3 per cent), company secretary (7.4 per cent) and other positions (4.4 per cent).

Table 5.3: Respondents' corporate positions

Positions	Number of Respondents	Percentage of Respondents
Chief Financial Officer	36	52.9
Chief Executive Officer	17	25.0
Finance Director	7	10.3
Company Secretary	5	7.4
Other	3	4.4
Total	68	100

Source: Survey 2012

5.3. Non-Response Bias Tests

One of the potential limitations of survey research is non-response bias. Non-response bias refers to the bias that exists when respondents to a survey are different from those that did not respond in terms of demographic or attitudinal variables (Sax *et al.*, 2003). The presence of non-response bias in a survey suggests that the viewpoints of non-respondents are significantly different from those of the respondents (Wallace and Mellor, 1988). In the research methodology literature, estimating non-response is a challenge given that, in most cases, the identity of the non-respondents is unknown (Devy, 1977). Although limited demographic information is sometimes available, these data may not reveal the uniqueness of non-respondents in terms of their attitudes or how they would have responded to survey items.

The conventional method for testing non-response bias is to compare the responses given to key questions by early and late respondents, using late respondents as a proxy for non-respondents (Wallace and Mellor, 1988; Roberts, 1999; Johnson, 2000). This experiment was suggested by Wallace and Mellor (1988) who opined that respondents who returned their questionnaires very late are similar to non-respondents. In this study, questionnaires were returned in the time period from 14th July to 30th September 2012. Respondents were classified into one of two groups, 'early' and 'late' respondents, according to the date their completed questionnaires were received. Those questionnaires received on or before 30th July were classified as 'early' while those returned later were classified as 'late'. The first

group consisted of 46 usable responses, while the second group comprised of 22 usable responses.

The existence of non-response bias was investigated in this study in two ways. First, the responses to categorical questions relating to the dividend-paying status and the change in the dividend payment levels of the sample firms were analysed by early and late respondents. Table 5.4 provides details of the test for non-response bias. Based on the results of the chi-square tests, there was no difference at the 5% level of significance between early and late respondents for dividend-paying/non-paying companies (chi-square= 3.483, p-value= 0.062) or for firms where the level of dividends have changed or not (chi-square=0.718, p-value= 0.397). Based on this result, the researcher is confident that the sample is a representative of the population.

Table 5.4: Results of Non-response Bias Tests

Question	Answer	Early	Late	Total	Chi-square (p-value)
Does your company pay dividends to shareholders each year?	Yes	37	13	50	3.483 (0.062)
	No	9	9	18	
Total		46	22	68	
Has the level of dividend paid changed since the previous year?	Yes	28	8	36	0.718 (0.397)
	No	10	4	14	
Total		38	12	50	

This table presents details about the 68 usable responses to the survey and the 50 dividend-paying firms analysing the responses between those received early and those received late. The responses are analysed between (i) dividend-paying and non-dividend-paying companies, and (ii) companies that have recently changed their dividend payment level and those who have not respectively.

A further test of non-response bias was performed by comparing the mean responses to each of the 26 close-end statements about dividend policy of the 46 firms that returned the survey after the first mailing with those of the 22 firms that returned the survey after the second mailing. A two tailed t-test was performed for responses received 'early' and 'late', to determine whether there was a significant difference between the two sets. Based on the t-tests, a significant difference between the mean responses to the first and second mailing exists for only two statements: a firm's dividend policy affects its share price (S11) and investors prefer cash dividends today to uncertain share price appreciation in the future

(S25). Based on the two experiments, the researcher concludes that non-response bias is small.

5.4. Empirical Results

Tables 5.5, 5.6, and 5.7 present the mean response, the standard deviation and the p-value of the responses from the five-point Likert scale. The respondents were asked to indicate the level of agreement/disagreement to close-ended statements on an increasing scale of 1 to 5. The five possible responses to each of the statement were “strongly disagree” (assigned a value of 1 for the analysis of the results), “disagree” (2), “uncertain” (3), “agree” (4) and “strongly agree” (5). The assigned values indicate that the higher the mean, the stronger the level of agreement with the statement in question. This information is supplied for the whole sample and for the sub-grouping of financial and non-financial firms. To test for industry differences, the responses of financial firms are compared to those of non-financial firms using a standard two-tailed *t*-test.

5.4.1. Factors influencing dividend decision

The first objective of this chapter is to ascertain the main factors that influence the dividend decision of Nigerian companies. Table 5.5 reports the results of the descriptive statistics showing the level of agreement/disagreement to each of the 10 factors, considered by managers of Nigerian listed firms in determining their firms’ dividend policy. These factors are listed on the table based on their mean level of agreement. This information is supplied for the whole sample and for the two broad groups of financial and non-financial firms. A visual inspection of the table reveals that managers from both groups ranked three factors (F4, F6 and F3), as measured by their means as the main factors influencing their firms’ dividend policy. These factors have mean scores of significantly above 4.00 (high level of agreement). However, some differences emerge when the views of managers of financial and non-financial firms are investigated separately.

The most highly ranked factor influencing dividend decision of Nigerian listed firms is the level of current earnings (F4). This statement had the highest mean score of 4.63 and the lowest standard deviation of 0.78. The associated p-value of 0.00 allows rejection of the null

hypothesis that the response mean is neutral. It has been established in the literature that there is a strong past and concurrent link between earnings and dividend changes (Benartzi *et al.*, 1997). Thus, the high ranking of this factor is not surprising given that firms pay cash dividends from earnings. This finding also lends support to the notion that firms with high (low) earnings distribute high (low) dividends. This result is consistent with the findings of earlier survey studies conducted by Lintner (1956), Green *et al.* (1993), McCluskey *et al.* (2003), and Baker *et al.* (2006) where respondents considered profitability as the most important factor influencing dividend policy. A test of equality of means shows no significant differences between the responses of managers of financial versus non-financial firms on this factor at the 0.05 level (p-value= 0.86).

The second highly ranked factor influencing dividend policy of Nigerian listed firms is the stability of earnings (F6) (mean score of 4.47 and standard deviation of 0.84). The associated p-value of 0.00 allows rejection of the null hypothesis that the response mean is neutral. This finding highlights the importance Nigerian corporate managers attach to keeping the size of the cash dividend from decreasing in the future. The literature suggests that firms with more volatile earnings will experience a reduction in earnings, which could lead to a cut in the cash dividend paid (Baker *et al.*, 2006). This result is consistent with survey findings by Baker and Powell (2000) and Baker *et al.* (2006), where respondents indicated that stability of cash flows/earnings is an important factor in making dividend decision. Apparently, a test for equality of means shows that disparity exists between how respondents from financial and non-financial firms view this factor at the 0.05 level (p-value=0.00). In particular, managers of financial firms expressed a stronger preference to determine current dividends based on the stability of earnings (mean score of 4.87 and standard deviation of 0.34) than their non-financial counterparts (mean score of 4.26 and standard deviation of 0.94). This finding is not surprising given that financial firms tend to be more concerned about stable earnings because financial institutions, particularly banks, have a long history of paying dividends. This result is consistent with the survey findings reported by Baker *et al.* (2008), where managers of Canadian financial firms gave the highest support to the stability of earnings as a factor influencing dividend policy than their counterparts from non-financial firms.

The third highly ranked factor influencing dividend decision of Nigerian listed firms is cash flow/liquidity considerations such as the availability of cash (F3). This statement had a mean score of 4.38 and a standard deviation of 0.88. The associated p-value of 0.00 allows rejection of the null hypothesis that the response mean is neutral. The high ranking of this factor suggests that the responding managers recognize that firms pay dividends from cash, not on earnings based on accrual accounting. Such a result is consistent with the survey findings reported by McCluskey *et al.* (2003) and Baker *et al.* (2006) where respondents considered liquidity constraints such as the availability of cash to be an important determinant of dividend policy. Yet, significant differences exist in the views of managers of financial and non-financial firms on this issue. A test for equality of means shows that responses to this factor is significantly different at the 0.05 level (p-value=0.00). Specifically, respondents from non-financial firms expressed more support to cash flow/liquidity constraints as a factor influencing dividend policy (mean score of 4.60 and standard deviation of 0.81) than their financial counterparts (mean score of 3.96 and standard deviation of 0.88). A possible explanation is that managers of financial firms are relatively less concerned about the level of cash flow since they are more profitable and enjoy more liquidity than non-financial firms.

Another highly rated factor influencing the dividend policy of Nigerian listed firms is concern about affecting share price (F8) (mean score of 3.65). Although this factor generated a mean score below 4.00, the relative high ranking of this factor suggests that corporate managers make the dividend decision with a view towards increasing the firm's share price. While the debate on the influence of dividend policy on share prices continues among academics, the evidence from the interviews with the financial managers reported in chapter 7 of this thesis suggests that financial managers of Nigerian listed companies believe that firms make their dividend decisions to influence share prices. The interviewees stated that one of the main reasons why companies are hesitant to cut dividends is related to affecting the share price. Overall, the evidence from both the questionnaires and interviews suggest that Nigerian companies consider the prevailing share prices of their companies when making their dividend decisions.

Of the remaining 6 factors, three factors have mean scores of slightly above 3.00 for the whole sample and thus represent factors, on average, of low level of importance. Although

the average response to these factors: the pattern of past dividends (F2), the current degree of financial leverage (F5) and the level of expected future earnings (F7) is significantly positive, and their mean scores are slightly above 3.00 in the whole sample, the percentage of no opinion responses are high. The remaining three factors (F1, F9 and F10) have mean scores of significantly below 3.00 for the whole sample. The ranking of these factors suggests that the responding Nigerian managers disagreed with the views that a firm should determine its current dividends based on availability of profitable investment opportunities (F1), the preference of shareholders such as the need for dividend income (F9) and the dividend distributions of competitors (F10). The three factors had relatively high standard deviations, indicating very little consensus among responding firms. The associated p-value of 0.00 for these factors allows the rejection of the null hypothesis that the response means are neutral. Of particular interest here is F1 (availability of profitable investment opportunities). A major implication of the low ranking of this factor is that corporate managers of Nigerian listed firms do not consider dividends as a residual cash flow (i.e. left over after investment choices), as Miller and Modigliani (1961) dividend irrelevance theory suggests it should be. This evidence regarding the importance of dividend payments to managers of Nigerian listed companies is confirmed by the findings of the interviews with the financial managers in Chapter 7 of this thesis. Indeed, the interviewees indicated that they would strive to maintain the level of the dividend and would attempt to borrow externally to fund an extremely large positive NPV project than cutting dividends. This evidence is consistent with the survey findings of Brav *et al.* (2005), where respondents indicated that maintaining the level of the dividend is more important than pursuing some positive NPV projects.

5.4.2 The Dividend Setting Process: Benchmarking to Lintner (1956)

The survey also sought the views of corporate managers regarding how firms set the amount of dividends they pay to their shareholders. To date, Lintner's (1956) behavioural model of dividend policy remains the most authoritative study on the dividend setting process. The study offers two key results. First, corporate dividend decisions are made conservatively. This is reflected in the unwillingness of managers to cut dividends. Second, the starting point for most payout decisions was the payout ratio (i.e. dividends as a

proportion of earnings). The questionnaire contains five statements (S1-S5) on the dividend setting process as described by Lintner (1956). As Panel A of Table 5.6 shows, the responses to the survey provides a rich view of the dynamics of setting dividend payments in Nigeria, as managers of both groups agreed with S1 through S3, but disagreed with S4 and S5.

The responses to this survey generally indicate that dividend decisions are still made conservatively but that the importance of targeting the payout ratio has declined in recent years. Specifically, the respondents expressed the highest level of agreement with the statement that a firm should avoid making changes in the dividend rate that might have to be reversed in the future (S1). This statement had the highest mean score of 4.46 and the lowest standard deviation of 0.58, indicating high degree of consensus among firms. The associated p-value of 0.00 rejects the null hypothesis that the response mean is neutral. This apparent reluctance by managers to increase their firm's dividend to a level that might have to be reversed in the future can be explained by their awareness of the signalling effects associated with a dividend cut. This finding of the extreme reluctance on the part of management to cut dividends provides ample evidence that dividend policy is made conservatively consistent with Lintner's (1956) model. There are no significant differences between the responses of managers of financial and non-financial firms on this issue. There was also strong agreement that a firm should strive to maintain an uninterrupted record of dividend payments (S3), and that the market places greater value on stable dividends than stable payout ratio (S5) (mean scores of 4.43 and 4.12 respectively). This evidence of conservatism in attitudes to dividend policies is consistent with the findings reported in prior survey studies by Baker and Powell (1999), Brav *et al.* (2005), Dhanani (2005), Baker and Smith (2006) and Kester and Robbins (2011). However, significant differences emerged in the views of managers of financial versus non-financial firms in this regard. While managers from financial firms expressed strong support for the statement that firms should strive to maintain an uninterrupted record of dividend payments (S3), their counterparts from non-financial firms expressed more support for the statement that the market places greater value on stable dividends rather than payout ratios (S5).

In contrast to Lintner (1956), however, corporate managers of Nigerian listed firms disagreed with two statements about the dividend setting process. Specifically, the high disagreement level for statement (S2) refutes the role of payout ratio as an important

aspect of dividend policy after determining the firm's earnings. This statement had a mean score of 2.72 and a standard deviation of 1.12. The high level of agreement with the statement that the market places greater value on stable dividends than stable payout ratios (S5) reinforces this finding. These results contrast markedly with the Lintner's (1956) model, but are consistent with the findings of Robinson (2006) in a survey of corporate managers in the emerging market of Barbados, where firms appeared to target the dividend per share rather than the payout ratio. Yet, significant differences emerged in the managerial views of financial versus non-financial firms. In particular, managers of financial firms seem to be more inclined to support the view that a firm should desire to maintain a target payout ratio and periodically adjust the target towards this ratio (mean score of 3.35) than their counterparts from non-financial firms (mean score of 2.40), which could be explained by the fact that financial industry may view dividends as an indicator of financial health. The respondents also disagreed with the statement that a firm should view cash dividends as residual after financing investment from earnings (S4) (mean of 2.77 and standard deviation of 1.10). The associated p-value of 0.00 allows the rejection of the null hypothesis that the mean response is neutral on this issue. This statement had relatively high standard deviation, indicating very little consensus among respondents. The high disagreement level for this statement suggests that responding managers recognize the fact that adopting a pure residual theory could lead to high volatility of dividends because such a policy could result in a firm paying no dividends during a period of potential investment opportunities and paying high dividends during scarcity of investment opportunities.

In a nutshell, the results from this survey show the dynamics of the dividend setting process in Nigeria. Consistent with Lintner's (1956) postulations, listed firms in Nigeria exhibit a conservative dividend policy. Nigerian corporate managers recognise the negative consequences of a dividend cut, and as a result avoid making changes in the dividend per share that might have to be reversed in the future. Thus, the dividend policy of Nigerian firms appears to be a sticky one. In contrast to Lintner's postulation, however, the variable targeted by Nigerian firms appears to be the dividend per share rather than the dividend payout ratio.

Table 5.5: Perspectives on the Factors that Influence Dividend Decision of NSE listed Companies

S#	Factor <i>A firm should determine its current dividends based on:</i>	Total			Financial		Non-financial		<i>Financial V. Non-financial</i>
		Mean	SD	p-value	Mean	SD	Mean	SD	
F4	The level of current earnings.	4.63	0.78	0.00*	4.61	0.89	4.64	0.74	0.86
F6	The stability of earnings.	4.47	0.84	0.00*	4.87	0.34	4.27	0.94	0.00*
F3	Cash flow/liquidity considerations such as the availability of cash	4.38	0.88	0.00*	3.96	0.88	4.60	0.81	0.00*
F8	Concern about affecting the share price	3.65	1.13	0.00*	4.09	0.60	3.42	1.27	0.01*
F7	The level of expected future earnings.	3.15	1.27	0.00*	2.83	1.40	3.31	1.18	0.14
F2	The pattern of past dividends	3.12	1.07	0.00*	3.30	1.02	3.02	1.10	0.31
F5	The current degree of financial leverage	3.07	1.05	0.00*	3.22	1.04	3.00	1.07	0.43
F10	The dividend distributions of competitors	2.94	1.21	0.00*	2.83	1.30	3.00	1.17	0.58
F1	Availability of profitable investment opportunities	2.87	1.30	0.00*	2.04	1.02	3.29	1.24	0.00*
F9	The preference of shareholders such as the need for dividend income	2.72	1.06	0.00*	2.70	1.06	2.73	1.07	0.89

This table presents descriptive statistics reflecting the responses for 23 financial and 45 non-financial Nigerian listed firms to ten factors influencing dividend policy (F1 to F10). The factor number in the survey is given in column 1. Column 2 lists each of the 10 factors based on their mean scores. The mean, standard deviation, and p-value for each of the factor for the whole sample are given in columns 3, 4, and 5 respectively. Columns 5 and 6 list the mean and standard deviation for financial firms, while columns 7 and 8 give the mean and standard deviation for the non-financial firms. Column 9 provides p-values for the null hypothesis that the mean response to a statement for two subgroups is equal using a two-tailed t-test. An * indicates that the p-value is significant at the 5% level.

5.4.3. Dividend policy and firm value

The issue of whether dividend policy affects firm value has been a contentious topic in the corporate finance literature. Miller and Modigliani (1961) demonstrated that in a perfect capital market, a firm's dividend policy is irrelevant to its market value. In other words, the authors argued that firm value is not affected by the dividend policy of the firm. Six statements (S6-S11) in the survey sought the views of corporate managers of Nigerian listed firms on the relationship between dividend policy and firm value. Panel B of Table 5.6 reports the results of this study.

The survey results indicate that managers of Nigerian listed firms overwhelmingly believe that dividend policy is relevant to firm valuation. The respondents expressed the highest level of agreement with the statement that a change in a firm's dividend policy affects its value (mean of 4.60 and standard deviation of 0.49). The associated p-value of 0.00 rejects the null hypothesis that the response mean is neutral. Managers of both groups strongly believe that dividend policy influences firm value in that a change in dividend policy affects both the share price (S11) and the cost of capital (S10) of a firm. The respondents also expressed high level of agreement with the statements that an optimal dividend policy strikes a balance between current dividends and future growth that maximizes share price (S8) and that a firm should formulate its dividend policy to produce maximum value for its shareholders (S7). These findings are inconsistent with Miller and Modigliani (1961) dividend irrelevance theory, but consistent with prior surveys on management views about dividend policy by Baker *et al.* (1985), Baker and Powell (1999), and Brav *et al.* (2005). These findings are not surprising given that Miller and Modigliani's (1961) restrictive assumptions do not hold in the real world. This finding also suggests that corporate managers recognize the importance of dividend payments in the realization of corporate goal of shareholder wealth maximization. However, significant differences exist in the views of managers of financial and non-financial firms on S7, S10 and S11. In particular, managers of financial firms show more support to the statements that a firm should formulate its dividend policy to produce maximum value for its shareholders (S7) and that a change in a firm's dividend policy generally affects its share price (S11) than managers of non-financial firms. In contrast, respondents from non-financial firms show stronger agreement with the

statement that a change in dividend policy generally affects the firm's cost of capital (S10) than their counterparts from financial firms. A possible explanation is that financial firms place more value on dividend relevance than their counterparts in the non-financial industries. These findings are consistent with Baker *et al.* (2008) study on the dividend policy of Canadian financial and non-financial firms.

In terms of the relationship between investment, financing and dividend decisions of a firm, the corporate managers of Nigerian firms expressed moderate support for the notion that a firm's investment, financing, and dividend decisions are interrelated (S9) (mean score of 3.82). A primary tenet of corporate finance theory is the separation of investment, financing, and dividend decisions of a firm. Therefore, the result of this present study contrasts sharply with Miller and Modigliani (1961), where firm value is independent of the manner in which the firm finances its productive resources. The level of support for this statement suggests that Nigerian corporate managers do not see dividends as a residual. Baker *et al.* (2008) reported a mixed view on this issue in their survey of corporate managers of Canadian financial and non-financial firms. Overall, the evidence from this study suggests that corporate managers of Nigerian listed firms believe that one or more of the assumptions of perfect capital markets are constantly violated in the Nigerian context.

5.4.4 Explanations for Paying Dividends

Despite extensive theorising to explain their pervasive, dividends remains one of the longest standing puzzles in the literature of modern finance. Miller and Modigliani (1961) argued that firm value is unrelated to dividend policy in a perfect and frictionless capital market. However, in the presence of capital market imperfections, financial economists put forward various theories to explain how dividend policy can affect firm valuation. This sub-section focuses on Nigerian managers' views on the four standard explanations for paying dividends: signalling, tax-preference, agency, and bird-in-the-hand explanations. Table 5.7 presents managerial responses to these theories.

Table5.6: Perspectives on the Dividend Setting Process and on the Dividend Policy and Firm Value for NSE-listed Companies

S#	Statement	Whole Sample			Financial		Non-financial		Financial V. Non-financial
		Mean	SD	p-value	Mean	SD	Mean	SD	p-value
	<u>Panel A: Dividend setting process</u>								
S1	A firm should avoid making changes in the dividend rate that might have to be reversed in the future	4.46	0.58	0.00*	4.48	0.51	4.44	0.62	0.82
S3	A firm should strive to maintain an uninterrupted record of dividend payments.	4.43	0.74	0.00*	4.70	0.47	4.29	0.82	0.03*
S5	The market places greater value on stable dividends rather than stable payout ratios.	4.12	0.97	0.00*	3.61	1.03	4.38	0.83	0.00*
S4	A firm should view cash dividends as a residual after financing investment from earnings.	2.77	1.10	0.00*	2.74	1.05	2.78	1.15	0.89
S2	A firm should desire to maintain a target dividend payout ratio and periodically adjust this ratio to the target.	2.72	1.12	0.00*	3.35	1.19	2.40	0.94	0.00*
	<u>Panel B: Dividend policy and firm value</u>								
S6	A change in a firm's dividend policy affects its value	4.60	0.49	0.00*	4.61	0.50	4.60	0.49	0.95
S11	A firm's dividend policy generally affects its share price.	4.56	0.58	0.00*	4.87	0.34	4.40	0.62	0.00*
S8	An optimal dividend policy strikes a balance between current dividends and future growth that maximizes share value	4.37	0.64	0.00*	4.48	0.73	4.31	0.60	0.32
S10	A firm's dividend policy generally affects its cost of capital.	4.36	0.86	0.00*	4.00	1.09	4.56	0.66	0.01*
S7	A firm should design its dividend policy to produce maximum value for its shareholders.	4.24	0.87	0.00*	4.52	0.51	4.09	0.97	0.05*
S9	A firm's investment, financing and dividend decisions are interrelated.	3.82	1.10	0.00*	3.61	1.16	3.93	1.07	0.26

This table presents descriptive statistics reflecting the respondents' opinions on eleven statements related to the dividend setting process (S1-S5) and dividend policy and firm value (S6-S11). The statement number in the survey is given in column 1. Column 2 lists each of the 11 statements. The mean, standard deviation, and p-value for each of the statements for the whole sample are given in columns 3, 4, and 5 respectively. Columns 5 and 6 list the mean and standard deviation for the financial firms, while columns 7 and 8 give the mean and standard deviation for the non-financial firms. Column 9 provides p-values for the null hypothesis that the mean response to a statement by two subgroups is equal using a two-tailed t-test. An* indicates that the p-value is significant at the 5% level

5.4.4.1 Signalling Explanation

Panel A of Table 5.7 provides the respondents' views on six statements (S12 through S17) about the signalling explanation for paying dividends. The overwhelming positive responses to the statements involving signalling confirms believe in the role of dividend policy as a relevant signalling mechanism from a managerial perspective. Specifically, Nigeria corporate managers agreed with the notion that investors generally regard dividend changes as a signal for future earnings prospects (S13) and that investors use dividend announcements as information in assessing a firm's share value (S16). These two statements are the most direct statements involving the signalling explanation for paying dividends. Both statements generated mean scores of 4.60 and 4.44 respectively. S12, which inquired into the relevance of dividends as a mechanism by which investors assess the state of affairs of the business also generated a high level of agreement among corporate managers (mean score of 4.43). Corporate managers also agreed that reasons for dividend policy changes should be adequately disclosed to investors (S17) (mean score of 4.31). These findings are consistent with the recent findings reported for US firms by Brav *et al.* (2005), UK firms by Dhanani (2005), and Norwegian firms by Baker *et al.* (2006). However, the respondents appeared unsure about whether an unexpected increase (decrease) in dividends will lead to a rise (fall) in share price (mean scores of 3.25 and 3.15 respectively). Although the mean responses to both statements are significantly positive, the associated standard deviations of 1.21 and 1.15 respectively are the highest recorded in the table, indicating the diverse nature of views on these issues. However the associated p-values of 0.00 and 0.00 respectively allow the rejection of the null hypothesis that the population means are neutral suggesting that respondents appeared aware of the role of the signalling theory.

With respect to industry-related dividend effect on responses to the dividend signalling theory, the responses of managers of financial and non-financial firms differ significantly on three statements (S12, S13 and S14) involving the signalling explanation for paying dividends. Specifically, managers of financial firms expressed much stronger support to the statements about the signalling relevance of dividend policy than their counterparts from non-financial firms. For example, managers from financial firms appeared to be more certain of their views regarding the use of dividends as a signal of future prospects (mean score of 4.83) than managers of non-financial firms (mean score of 4.49). In a similar vein,

managers of financial firms show more support to the statement that an unexpected increase in dividends will generally lead to a rise in share price than those from non-financial firms as evidenced by their mean scores. These findings are consistent with the survey results reported by Baker *et al.* (2008) in their study of the dividend policy of Canadian financial and non-financial firms. Overall, the evidence suggests that managers of Nigerian listed firms favour signalling over the tax-preference, agency, and the bird-in-the-hand explanations for paying dividends. Based on the high ranking of the six statements relating to signalling, Nigerian managers appear to view the role of dividend policy as a signalling mechanism.

5.4.4.2 Tax-preference Explanation

In a frictionless world without taxes or transaction costs, dividends and repurchases are equivalent (Allen *et al.*, 2000). The dividend literature suggests that when dividends are tax disadvantaged relative to capital gains, investors prefer to receive cash through share repurchases than dividends. In Nigeria, dividend income is taxable while its equivalent from capital gains is exempted from taxation during the period of this survey. This tax system favours the return of cash to shareholders in the form of share repurchases in Nigeria. Five statements on the survey address the tax-preference explanation for paying dividends (S18 through S22). Panel B of Table 5.7 presents the responses to these statements.

The responses to the statements on tax-preference explanation for paying dividends could best be described as ambiguous or mixed. While the respondents displayed high level of agreement with the statements that a firm should be responsive to the dividend needs of its shareholders (S18) and that investors generally prefer to invest in firms whose dividend policies suit their tax status (S19) (mean scores of 4.18 and 4.04 respectively), they were unsure about whether investors in high (low) tax brackets are attracted to low (high) dividend shares (S20 and S21) (mean scores of 2.89 and 2.87 respectively). These results are consistent with prior studies by Baker and Powell (1999), McCluskey *et al.* (2003), and Robinson (2006). Surprisingly, corporate managers displayed high disagreement level with the statement on whether the introduction of 10% withholding tax has made dividend payments less attractive to shareholders (mean score of 1.88, p-value=0.00). This evidence suggests that Nigerian corporate managers believe that investors prefer current income to

the capital gains that are expected to result from reinvesting their shares, despite the tax consequences associated with receiving dividends in cash. No significant differences exist in the views of the managers of financial and non-financial firms, except for S20. Overall, the responses of corporate managers to the tax explanation for paying dividends suggest that there are other factors that affect the demand for dividends in Nigeria other than taxation of dividends.

5.4.4.3 Agency Explanation

Corporate dividend policy can be used as a self-imposed disciplinary mechanism to manage agency conflicts arising from the separation of ownership and management. The dividend literature suggests that increase in the dividend payout helps to reduce the incentives of managers to squander the cash of the company by investing in negative NPV projects (Easterbrook, 1984; Jensen, 1986). Panel C of Table 5.7 presents the responses to two statements involving the agency explanation for paying dividends (S23 and S24).

The results show that corporate managers of Nigerian listed firms provide little/no support for the disciplinary role of dividends in managing agency problems. Although the respondents displayed moderate level of agreement with the statement that the payment of dividends forces a firm to seek external financing which subjects the firm to the scrutiny of investors (S24), they strongly disagreed with the statement that the payment of dividends act as a bonding mechanism to encourage managers to act in the interest of outside shareholders (S23) (mean scores of 3.31 and 2.43 respectively). The low level of agreement with statements on agency theory suggests that corporate managers of Nigerian firms do not believe in the disciplinary role of dividends, and as such make dividend payments for reasons other than resolving the agency conflicts. This evidence is not surprising given the ownership structure of companies in Nigeria, where major shareholders often enjoy potentially powerful monitoring roles due to their presence on the Board of Directors which creates little incentive for the use of dividends as a disciplinary mechanism. This finding is consistent with the results reported by Dhanani (2005) for UK companies and Robinson (2006) for publicly listed firms in Barbados. No significant differences exist in the views of managers of financial versus non-financial firms on this issue.

5.4.4.4 The Bird-in-the-hand Explanation

The two statements reflecting the bird-in-the-hand explanation for paying dividends (S25 and S26) command mixed agreements. While the respondents moderately agreed with the statement that investors perceive cash dividends to be less risky than capital gains (S26), they, however, disagreed with the statement that investors prefer cash dividends today to uncertain share appreciation (S25). Both statements generated mean scores of 3.78 and 2.74 respectively. This result is consistent with the findings of Baker and Powell (1999) who reported mixed evidence on the bird-in-the-hand theory among corporate managers in the US. These observations, however, appear to contradict sharply with the findings of Robinson (2006) who documented strong support for the view that dividends are the proverbial 'bird-in-hand' in a survey of corporate managers in an emerging market of Barbados.

In summary, the managers of Nigerian listed firms that took part in this survey favour the signalling explanation for paying dividends, in preference to the tax-preference, agency, and bird-in-the-hand explanations. The implication of this result is that firms use dividends to signal to investors' information about their current performance and future prospects. The high level of agreement with statements involving the signalling theory is not unexpected given that the Nigerian equity market is characterised by information asymmetry.

Table 5.7: Perspectives on the Various Explanations for Paying Dividends for NSE-listed Companies

S#	Statement	Whole sample			Financial		Non-financial		Financial V. Non-financial
		Mean	SD	p-value	Mean	SD	Mean	SD	p-value
Panel A: The Signalling Explanation									
S13.	Investors generally regard dividend changes as a signal of future earnings prospects.	4.60	0.49	0.00*	4.83	0.38	4.49	0.51	0.03*
S16.	Investors generally use dividend announcements as information to help assess a firm's share value.	4.44	0.84	0.00*	4.57	0.73	4.38	0.89	0.39
S12.	Dividend announcements provides subtle signal about the state of affairs of the business.	4.43	0.72	0.00*	4.78	0.42	4.24	0.77	0.00*
S17.	A firm should adequately disclose to investors its reasons for changing its cash dividend.	4.31	0.78	0.00*	4.52	0.51	4.20	0.87	0.11
S14.	An unexpected increase in dividends will generally lead to a rise in share price.	3.25	1.21	0.00*	3.74	1.25	3.00	1.13	0.02*
S15.	An unexpected decrease in dividends will generally lead to a fall in share price.	3.15	1.15	0.00*	3.48	1.27	2.98	1.06	0.09
Panel B: The Tax-preference Explanation									
S18.	A firm should be responsive to the dividend preferences of its shareholders.	4.18	0.98	0.00*	4.35	0.88	4.09	1.02	0.30
S19.	Investors generally prefer to invest in firms whose dividend policies suit their tax status.	4.04	0.99	0.00*	4.04	1.06	4.04	0.98	0.99
S20.	Investors in high tax brackets are attracted to low dividend shares.	2.89	0.85	0.00*	2.57	0.90	3.07	0.78	0.02*
S21.	Investors in low tax brackets are attracted to high dividend shares.	2.87	0.79	0.00*	2.65	0.88	2.98	0.72	0.11
S22.	The introduction of the 10% dividend withholding tax has made dividend payments to shareholders less attractive.	1.88	0.87	0.00*	1.61	0.58	2.02	0.97	0.06
Panel C: The Agency Explanation									
S24.	The payment of dividends forces a firm to seek external financing which subjects the firm to the scrutiny of investors.	3.31	1.11	0.00*	3.52	1.20	3.20	1.06	0.26
S23.	The payment of dividends acts as a bonding mechanism to encourage managers to act in the interest of outside shareholders.	2.43	0.90	0.00*	2.52	1.04	2.38	0.83	0.54
Panel D: The Bird-in-the-hand Explanation									
S26.	Investors perceive cash dividends to be less risky than capital gains	3.78	0.79	0.00*	3.83	0.94	3.76	0.71	0.73
S25.	Investors prefer cash dividends today to uncertain share appreciation.	2.74	1.03	0.00*	2.70	1.11	2.75	1.00	0.82

This table presents the statistics reflecting the responses of 23 financial and 45 non-financial Nigerian listed firms on four standard explanations for paying dividends-signalling (S12-S17), tax preference (S18-S22), agency (S23-S24) and bird-in-the-hand theory (S25-S26). An * indicates that the p-value is significant at the 5% level.

5.5. Administration of Dividend Policy

The questionnaire survey contains some questions about the firm's existing dividend policy. Table 5.8 reports the results of the three questions about the administration of dividend policy. The first question concerns the most influential person in developing the firm's dividend policy. As Panel A shows, the most influential person in determining the dividends Nigerian listed firms pay to their shareholders is the CFOs with 57.4 per cent followed by the chief executive officer (CEOs) with 38.2 per cent. Other company executive other than the CFO or CEO is most influential at 4.4 per cent of the firms. There is no significant difference between the responses of managers of financial versus non-financial firms on this issue.

The survey also asked the respondents to indicate how frequently their firms formally re-examine their dividend policy. As Panel B shows, 79.4% of the respondents indicate that their firms re-examine dividend policy annually, while 14.7% reported quarterly re-examination of dividend policy. The remaining 5.9% reported that their firms re-examine their dividend policy at some other time interval. This result is not surprising given that most Nigerian listed companies declare dividends normally at the end of their financial year. There is no significance difference between the responses of managers of financial firms from those of the non-financial firms on this issue.

The third question focuses on whether firms have an explicit payout ratio (a long-term desired dividend-to-earnings ratio). As panel C indicates, 72.1% of the responding firms do not have an explicit target payout ratio, while 22.1% indicated that they have. The remaining 4.9% of the respondents are unsure whether they have a target payout ratio or not. This evidence of not having a target payout ratio by most of the responding firms reinforces the result reported in section 5.4.2, that the market places greater value on stable dividends than stable payout ratios in Nigeria. However, significant differences emerge in the views of managers of financial and non-financial firms on this issue. In particular, larger proportion of financial firms indicated that they have an explicit target payout ratio than their non-financial counterparts. The chi-square test of independent samples is significant at the 0.05 level (p-value 0.01).

Table 5.8: Administration of dividend policy in Nigeria

Question		Whole Sample		Financial firms		Non-financial firms		Chi-Square	df
		n	%	n	%	n	%		
Panel A:	<i>Who is the most influential in developing the dividend policy approved by your board of directors?</i>							2.047	2
	Chief Financial Officer	29	42.7	9	39.1	20	44.4		
	Chief Executive Officer	36	52.9	14	60.9	22	48.9		
	Other	3	4.4	0	0.0	3	6.7		
	Total	68	100.0	23	100.0	45	100.0		
Panel B:	<i>How often does your company re-examine its dividend policy?</i>							4.411	2
	Quarterly	10	14.7	6	26.1	4	8.9		
	Annually	54	79.4	15	65.2	39	86.7		
	Other	4	5.9	2	8.7	2	4.4		
	Total	68	100.0	23	100.0	45	100.0		
Panel C:	<i>Does your company have an explicit target payout ratio (a long-term desired dividend-to-earnings ratio)?</i>							10.437*	2
	Yes	15	22.1	10	43.5	5	11.1		
	No	49	72.1	13	56.5	36	80.0		
	Don't Know	4	5.9	0	0.0	4	8.9		
	Total	68	100.0	23	100.0	45	100.0		

This table presents the responses of 23 financial and 45 non-financial Nigerian listed firms to questions about the administration of dividend policy. Panel A identifies the person who is the most influential in developing dividend policy. Panel B indicates how often companies re-examine their dividend policies. Panel C shows the proportion of companies that have target payout ratios. The chi-square tests show the differences between the responses from financial and non-financial firms. A* indicates that the p-value is significant at the 5% level.

5.6 Conclusion

This chapter investigated the perceptions of corporate managers on the factors that drive dividend decision and the relevance of dividend policy to firm value in an emerging market with a distinctive institutional background. While there are no tax on dividends and capital gains in other countries with emerging stock markets such as Tunisia and the UAE (Naceur *et al.*, 2006; Chazi *et al.*, 2011), personal income from dividends is taxable while capital gains are exempt from taxation in Nigeria. Theoretically, this system of taxation favours the distribution of earnings in the form of stock dividends in Nigeria. In addition, the Nigerian corporate context is characterised by high ownership concentration which may increase the agency problems between managers and outside investors. These factors make the country an ideal research environment for investigating the motivations for paying dividends. The study also compared the perspective of managers of financial versus non-financial firms where appropriate. The findings of this survey provided insights into the dividend puzzle unavailable by relying solely on market data.

First, the results suggest that the perceptions of managers of financial versus non-financial firms differ on some of the factors influencing the dividend policy of Nigerian firms. Nonetheless, managers of both groups ranked the level of current earnings, stability of earnings, and cash flow/liquidity considerations such as the availability of cash as the main factors influencing the dividend decision of their companies. Specifically, managers of financial firms are more inclined to determine their current dividends based on stability of earnings than their non-financial counterparts. In contrast, managers of non-financial firms gave more support to cash flow/liquidity constraints as a factor influencing dividend policy than managers of financial firms.

Second, the responses of Nigerian managers to statements about the dividend setting process highlighted the dynamics of setting dividend policy in Nigeria. Corporate managers of Nigerian listed firms' exhibit a conservative dividend policy as described by Lintner (1956), in that they avoid making changes in the dividend rate that might have to be reversed in the future. In contrast to Lintner's postulation, however, the variable targeted by Nigerian companies appears to be the dividend per share rather than the dividend

payout ratio. Thus, corporate managers of Nigerian listed firms consider dividend decisions as a flexible goal.

Third, corporate managers of Nigerian listed firms overwhelmingly provide support for the notion that dividend policy is relevant to firm valuation. Nigerian corporate managers believe that a change in a firm's dividend policy affects not only the share price, but also its cost of capital. In addition, Nigerian managers also agreed with the statements that an optimal dividend policy strikes a balance between current dividends and future growth that maximizes share price and that a firm should design its dividend policy to produce maximum value for shareholders. Yet, significant differences emerged in the perspective of managers of financial versus non-financial firms on this issue. Compared to their non-financial counterparts, respondents from financial firms expressed more agreement with the notions that a change in dividend policy generally affects share price and that a firm formulates its dividend policy to produce maximum value for shareholders. In contrast, managers of non-financial firms show stronger support to the statement that a change in the dividend policy of a firm generally affects its cost of capital than their counterparts from financial firms.

Finally, corporate managers of Nigerian listed firms tend to favour the signalling explanation for paying dividends, in preference to the tax-preference, agency costs, and the bird-in-the-hand explanations. Yet, the perceptions of managers from financial versus non-financial firms differ on the signalling explanation for paying dividends. In particular, managers from financial firms expressed much stronger support to the statements about the signalling relevance of dividend policy than their counterparts from non-financial firms. Overall, the overwhelming positive responses to the statements involving signalling confirms believe in the role of dividend policy as a relevant signalling mechanism from a managerial perspective.

CHAPTER SIX

THE INFORMATION CONTENT OF CASH DIVIDEND ANNOUNCEMENTS IN NIGERIA

6.1. Introduction

The impact of dividend announcements on share prices remains a puzzle. Miller and Modigliani (1961) argue that the dividend paid by a firm does not influence its market value since it will be matched with an equivalent capital loss. However, contrary to their theoretical assumption, numerous empirical studies have examined the impact of dividend announcements on share prices and have documented positive association between announced changes in dividends and share price movements (Petit, 1972; Charest, 1978; Aharony and Swary, 1980; Easton, 1991; McCluskey *et al.*, 2006; Al-Yahyaee *et al.*, 2011; among others). The majority of these studies have been conducted in countries with developed capital markets such as the US and the UK; very little research has been conducted on the information content of dividend announcements in emerging stock markets, such as Nigeria.

This chapter investigates the share price reactions to cash dividend announcements in Nigeria to determine whether or not dividends convey price-sensitive information to the market. Due to its distinctive institutional background, the Nigerian stock market can be considered an interesting environment to examine the stock market reaction to cash dividend announcements. First, personal income from dividends is subject to withholding tax, while capital gains are exempt from taxation in Nigeria. Bhattacharya (1979) and John and Williams (1985) argue that dividends would not be informative if not for the higher tax on dividends relative to capital gains. Thus, the imposition of tax on dividends and no tax on capital gains suggests that dividends will be informative about the company's future prospects and cash flow in Nigeria. Second, there is low shareholder protection, lack of access to information by all shareholders and poor corporate governance in Nigeria, which might make dividend announcements an important source of information in pricing shares in Nigeria. Third, the Nigerian corporate context is characterised by high ownership concentration with inactive trading of shares, which might make dividends valuable in solving agency and information problems (Tsu and Tsai, 2007). Finally, Nigerian listed

companies change their dividends often, which might affect the information content of dividend announcements. These characteristics, on average, suggest that dividends are more likely to be used to convey to investors' management expectations about future performance in Nigeria.

The remainder of this chapter is organised as follows. Section 6.2 provides the research approach and the hypotheses to be tested in the chapter, while section 6.3 describes the data and sample design used in this study. Section 6.4 presents the results of the study. Finally, section 6.5 concludes the chapter.

6.2. Research Approach and Hypotheses

The purpose of this chapter is to investigate the share price reaction to dividend announcements, in order to determine whether or not dividends contain information relevant to price formation. Chapter 4 provided detailed information about the research approach used to investigate stock market reaction to dividend announcements. This section of the chapter provides a brief description of the research approach and also states the hypotheses to be tested.

This chapter employs a standard event study methodology to examine the share price reaction to the firm-specific news of a dividend announcement. The primary use of event study methodology is to study security price behaviour around specific events and security price reaction to such events (Binder, 1998). It is also used to test the null hypothesis that markets are efficient and incorporate all available information, as identified in the efficient market hypothesis originally introduced by Fama (1970). Under this method, the actual share return is compared with the expected share return around the dividend announcement date in order to determine whether or not any stock market reaction has occurred. This chapter also examines the speed with which the Nigerian stock market reacts to corporate announcements about cash dividend payments. In other words, the current study tests the semi-strong form efficient market hypothesis on the Nigerian stock market. Consequently, two basic hypotheses are to be tested in the current chapter:

H1: An announcement of a change in dividend level conveys price-sensitive information to the market.

H2: The Nigerian stock market responds quickly and efficiently to new information emanating from cash dividend announcements.

6.3. Data and Sample Design

Using the NSE database, the researcher selected all Nigerian listed companies that announced cash dividends between January 1, 2008 and December 31, 2012. This time span coincided with spells of recession, recovery and boom in the Nigerian economy. As a result, the results of this study should not be specific to any one stage in the business cycle, but reflective of all economic conditions. The initial sample consists of 143 companies that made 422 dividend announcements. From this list of companies, the researcher observed that some companies also announced stock dividends during the cash dividend announcement date. The joint announcement of cash and stock dividends makes it difficult to determine which of the events is responsible for abnormal returns in share prices. To avoid the potential occurrence of abnormal returns being attributed to both events, the study considered only cash dividend announcements which are not associated with stock dividends activity around the cash dividend announcement date. This reduces the sample to 118 companies that made 326 dividend announcements.

A typical feature of the Nigerian stock market is the declaration of dividend on yearly basis. However, most of the listed companies also declare interim dividends or special dividends to shareholders occasionally (Campbell and Ohuocha, 2011). During the period of time covered by this study, some companies announced interim dividends around the event window. Since the focus of this study is on annual cash dividend announcements, including interim or special dividends may contaminate the data. Thus, interim dividends were excluded from the sample, thus reducing the sample to 112 companies that made 278 cash dividend announcements.

Furthermore, companies had to satisfy the following requirements to be included in the final sample of this study: (i) common stock are publicly listed on the Nigerian stock market for at least twelve months before and after the cash dividend announcement; (ii) the

company has made at least two annual cash dividend announcements during the 5-year period; (iii) closing stock price data is available for the period starting from 130 days prior to the dividend announcement date and at least 12 days following the dividend announcement date; (iv) data on the dividend per share is available from the Peace Capital Market database or the NSE library.

Table 6.1: Frequency of firm-year observations of the Sample Firms

Year	Dividend Increase	Dividend Decrease	No change in dividend	Total
2008	13	17	11	41
2009	21	27	14	62
2010	30	18	05	53
2011	31	13	12	56
2012	14	12	14	40
Total	109	87	56	252

This table shows the firm-year observations for a sample of Nigerian listed firms that announced cash dividends over the period 2008-2012. The sample contains 252 firm-year observations, consisting of 109 dividend increase, 87 dividend decrease, and 56 no change in dividends.

The final screening process (above) trimmed down the sample to 102 companies that made 252 cash dividend announcements, consisting of 109 dividend increases, 87 dividend decreases and 56 no change in dividends as shown in table 6.1. As the table indicates, 43% of the firms increase cash dividends ($n = 109$), approximately 35% decrease dividends ($n = 78$), and 22% have no change in dividends. The evidence from this table indicates that most Nigerian listed companies change their dividends frequently. The literature suggests that variability in cash dividends diminish the information content of dividends (Chen *et al.*, 2002). This implies that dividend announcements may send a weak signal to the Nigerian stock market.

The daily closing prices were obtained from the Peace Capital Market database and the NSE database. The announcement dates of the cash dividends, stock dividends (bonus issues), and interim dividends were extracted from the NSE library and the Peace Capital Market database. The stock index (NSE All-Share Index) was obtained from the NSE database and the Cashcraft Asset Management database. The dividend per share data is sourced from the Peace Capital Market database.

To calculate the change in dividends in the present study, the researcher obtained data on the announced dividend per share (DPS) in Naira, DIV_{it} . The DPS is used instead of the total dividend paid because of two reasons: (i) the DPS values incorporate any change in a firm's equity capital base over the period, which facilitates comparison of disbursements from one year to another; and (ii) prior studies on the information content of dividends made use of the DPS in their analyses (Kane *et al.*, 1984; Easton, 1991; Lonie *et al.*, 1996; McCluskey *et al.*, 2007; Al-Yahyaee *et al.*, 2011; among others); the use of a similar measure in the current analysis allows the results of this study to be compared with the findings of previous studies. Consequently, the change in the DPS was calculated as the absolute difference between the dividends paid from one year to the next using the formula:

$$\Delta DPS = DPS_{jt} - DPS_{jt-1} \quad [6.1]$$

Where ΔDPS_{jt} = is the change in DPS, DPS_{jt} is the actual DPS of firm j for the current year and DPS_{jt-1} indicates the DPS for the previous year.

6.4. Empirical Results

The dividend signalling hypothesis was examined in the present study by splitting the whole sample companies into three groups according to changes in the announced dividend level: dividend increase, dividend decrease, and no change in dividends. In order to test the null hypothesis that the daily average abnormal return is zero, the study employs a parametric t -test, where t -statistics are calculated using cross-sectional standard deviation. This test has been employed in many studies, including Graham *et al.* (2003), Martinez (2008), Adams and Mansi (2009), and Al-Yahyaee *et al.* (2011).

6.4.1 Share Price Reaction to Dividend Increase Announcements

Table 6.2 reports the stock price response to dividend increase announcements. If good news is being signalled to the stock market through an increase in dividends, logically one might assume that the stock market would react favourably. The results of this study are consistent with this proposition.

Table 6.2: Average daily abnormal returns around dividend increase announcements

Days	Market Model		Market-Adjusted Return	
	AR%	<i>t</i> -Statistics	AR%	<i>t</i> -Statistics
-10	-0.23	-0.82	-0.48	-1.65
-9	0.14	0.46	0.10	0.33
-8	-0.04	-0.14	-0.26	-0.82
-7	-0.02	-0.08	-0.09	-0.29
-6	-2.10	-1.09	-2.04	-1.06
-5	0.07	0.22	0.13	0.40
-4	-0.04	-0.13	0.01	0.05
-3	0.20	0.67	0.14	0.46
-2	-0.20	-0.61	-0.28	-0.83
-1	0.68**	2.22	0.61	1.93
0	0.82**	2.13	0.59	1.52
1	0.45	0.63	0.31	0.43
2	0.92***	3.01	0.85	2.60
3	0.58	1.88	0.68	2.27
4	-1.47	-1.52	-1.59	-1.63
5	1.95	1.94	1.90	1.87
6	-0.61	-2.04	-0.69	-2.19
7	0.03	0.07	0.06	0.13
8	-1.30	-1.06	-1.32	-1.07
9	1.08	0.87	1.16	-1.07
10	0.32	0.77	0.31	0.84

This table shows the abnormal returns (ARs) for the sample of 109 cash dividend increase announcements for 21 trading-days around the dividend announcement date ($t = 0$) using the market model and the market adjusted return. T-Statistics are for the null hypothesis that the average abnormal return is equal to zero. **significant at 5%; and ***significant at 1%.

The results show that investors who hold these companies' stocks earned a significant positive abnormal return on the dividend announcement date. Specifically, the average abnormal return earned on the dividend announcement date (day 0) by dividend increasing companies is 0.82%, with a *t*-statistic of 2.13. The positive share price reaction on the dividend announcement date is consistent with the notion that a dividend increase conveys positive information to the market resulting in share price appreciation. This finding is consistent with those found in the US and other stock markets (e.g., Asquith and Mullins, 1983; Lonie *et al.*, 1996; McCluskey *et al.*, 2007; Al-Yahyaee *et al.*, 2011). In the days preceding the dividend announcement, the average abnormal return is positive on three occasions, but significant only on day -1 (AR = 0.68%, *t*-statistic = 2.22). The presence of significant positive abnormal returns on day -1 shows an earlier market response to

dividend announcements, suggesting that there is an information leakage into the market before the actual announcement of cash dividends. During the post-announcement period, significant positive abnormal return is reported on day +2, which seems to suggest a delayed market reaction to the cash dividend announcement. The results documented using the market-adjusted returns are similar to those reported using the market model.

6.4.2 Share Price Reaction to Dividend Decrease Announcements

Table 6.3 documents the stock price response to dividend decrease announcements. The literature suggests that in a world of information asymmetry, an announcement of a cut in dividend may convey a pessimistic message about management's assessment of the future prospects of the firm (Ross, 1977; Bhattacharya, 1980; Lonie *et al.*, 1996; Gupta *et al.*, 2012). In response to such a signal, the stock market would react negatively resulting in a fall in share price of the dividend-decreasing companies. The results of this study support this assertion in the Nigerian context.

The results show that the market considers dividend reductions as bad news. Specifically, the sample of dividend-decreasing companies earned a significant negative abnormal return of -1.91%, with a *t*-statistic of -2.56 on the dividend announcement date (day 0). The negative share price reaction is consistent with the hypothesis that dividend decreases conveys negative information to the market about the firm's prospects. The results of this study confirms the findings of previous studies, which suggests that the market's adverse reaction to a dividend cut is much larger in absolute magnitude than those of dividend increases (Petit, 1972; Charest, 1978; Aharony and Swary, 1980; Lonie *et al.*, 1996). In the days prior to the dividend announcement, the dividend-decreasing companies earned a significant negative abnormal return of -0.70% (*t*-statistics = -2.29) on day -1. Once again, this result suggests that the market reacts before the cash dividend announcement. Similarly, investors experienced significant negative abnormal returns of -0.81% and -0.75% on day +1 and day +2 (*t*-statistics = -1.72 and -1.93 respectively). The presence of significant negative abnormal returns in the post-announcement period suggests that the market takes time to fully assimilate the news contained in dividend announcement into share prices. These results are at odds to those reported in previous studies, where the markets react

quickly and efficiently to incorporate news contained in dividend announcements (Petit, 1972; McCluskey *et al.*, 2006; Dasilas and Leventis, 2011). The results from the market-adjusted return are similar to those reported using the market model.

Table 6.3: Average daily abnormal returns around dividend decrease announcements

Days	Market Model		Market-Adjusted Return	
	AR%	<i>t</i> -Statistics	AR%	<i>t</i> -Statistics
-10	-0.18	-0.58	-0.29	-0.98
-9	0.43	1.33	0.31	0.93
-8	0.44	1.51	0.27	0.91
-7	-0.30	-0.97	-0.73	-2.17
-6	1.15	3.93	0.85	2.91
-5	0.54	1.85	0.47	1.55
-4	0.18	0.56	0.25	0.81
-3	-0.13	-0.39	-0.20	-0.64
-2	-0.69	-1.54	-0.77	-1.77
-1	-0.70**	-2.29	-0.87	-2.80
0	-1.91***	-2.56	-1.88	-2.55
1	-0.81*	-1.72	-0.75	-1.63
2	-0.75*	-1.93	-0.63	-1.72
3	-0.34	-1.01	-0.38	-1.08
4	-2.24	-1.36	-2.23	-1.35
5	1.42	0.84	1.29	0.76
6	-0.27	-0.77	-0.43	-1.19
7	-0.17	-0.39	-0.12	-0.27
8	-0.09	-0.21	-0.27	-0.66
9	-0.35	-0.54	-0.36	-0.54
10	0.08	0.15	-0.10	-0.16

This table shows the abnormal returns (ARs) for the sample of 87 cash dividend decrease announcements for 21 trading-days around the dividend announcement date ($t = 0$) using the market model and the market adjusted return. T-Statistics are for the null hypothesis that the average abnormal return is equal to zero. * Significant at 10%; **significant at 5%; and ***significant at 1%.

6.4.3 Share Price Reaction to No Change in Dividends Announcements

Table 6.4 provides the stock price response to no change in dividends. If no news is being signalled to the market by the decision not to change the dividend level, logically one might assume that no abnormal share price movements would be expected. In other words, only normal returns are expected on the announcement date as no new information is being

disclosed to the market. The results of this study are consistent with the suggestion in the literature.

Table 6.4: Average daily abnormal returns around no change in dividend announcements

Days	Market Model		Market-Adjusted Return	
	AR%	<i>t</i> -Statistics	AR%	<i>t</i> -Statistics
-10	-0.29	-0.81	-0.30	-0.69
-9	0.31	0.84	0.23	0.66
-8	-0.23	-0.44	0.05	0.11
-7	0.39	1.06	0.22	0.60
-6	-0.05	-0.15	0.14	0.41
-5	0.21	0.60	0.34	0.89
-4	-0.12	-0.33	-0.02	-0.02
-3	0.23	0.69	0.17	0.53
-2	0.06	0.15	-0.14	-0.37
-1	0.27	0.78	-0.08	0.24
0	0.21	0.46	0.01	0.03
1	-0.25	-0.47	-0.24	-0.46
2	-0.24	-0.56	-0.19	-0.48
3	-0.14	-0.39	-0.35	-0.89
4	0.49	1.44	0.21	0.57
5	0.01	0.02	-0.18	-0.47
6	0.38	0.72	0.30	0.55
7	0.29	0.78	0.30	0.80
8	-0.19	-0.51	-0.10	-0.27
9	0.33	0.75	0.17	0.41
10	0.31	0.73	0.14	0.29

This table shows the abnormal returns (ARs) for the sample of 56 no change in dividends announcements for 21 trading-days around the dividend announcement date ($t = 0$) using the market model and the market adjusted return. *t*-Statistics are for the null hypothesis that the average abnormal return is equal to zero.

The results show that the companies who did not alter their dividend payment level experienced insignificant market reactions on the ten days preceding and following the dividend announcement date. Specifically, the average abnormal return earned on day 0 is 0.27% (*t*-statistic = 0.46), which is statistically insignificant at any conventional level. The presence of statistically insignificant average abnormal return on the dividend announcement date supports the hypothesis that constant dividends are only associated with normal share returns. These results corroborate the findings of earlier studies in this area (Baraj and Vijh, 1990; Al-Yahyaee *et al.*, 2011; Dasilas and Leventis, 2011). However,

the positive signs on the dividend announcement dates contrasts with the results reported in Oman by Al-Yahyaee *et al.* (2011), but is consistent with those documented in the US by Bajaj and Vijh (1990). Similar to the market model, there is an insignificant market reaction to no change in dividends using market-adjusted return.

6.4.4 Cumulative Abnormal Returns

This study also calculates the cumulative average abnormal returns (CARs) for different interval. The null hypothesis to be tested is that the cumulative average abnormal returns will be equal to zero. The test statistic is the ratio of the cumulative average abnormal return to its standard error. Table 6.5 reports the results of this study.

Looking at the wealth effect surrounding cash dividend announcements, the results of this study shows that the market reacts positively to the announcements of dividend increases. The two-day event window (-1, 0) reveals a significant positive wealth effect surrounding an increase in cash dividend announcements. For the whole event window (-10, +10), the CARs are positive, but statistically insignificant. For the event window that precedes the announcement date (-10, -1), the CARs are negative and insignificant. On the other hand, the event window following the dividend announcement (+1, +10) shows that the CARs are positive but insignificant. For other event windows such as (+5, -5) and (+1, +5), the CARs are positive and statistically significant. The deductions using CARs from the market-adjusted return model are consistent with those from the market model.

For the sample companies that decrease dividends, the two-day event window (-1, 0) shows a significant negative reaction to dividend decreases. For the whole event window (-10, +10), the CARs are negative and statistically significant. The CARs are also negative and significant in the following event windows: (+1, +10), (+5, -5), (+1, +5), (-1, +1), and (0, +1). This finding is consistent with the hypothesis that dividend cut conveys negative information to the market resulting in share price drop. These results are similar whether we use the market model or the market-adjusted return.

For the firms that did not change their dividend payment level, the results show that that the CARs are insignificant in all event windows examined, using both the market model and

the market-adjusted return. This finding is consistent with the notion that announcements of a no change in dividends do not convey any new information to the market, resulting in insignificant market reaction.

Table 6.5: Cumulative Abnormal Returns for Dividend Increase, Dividend Decrease, and No Change in Dividends.

Days	Dividend Increase		Dividend Decrease		No Change in Dividends	
	Market Model	Market-Adjusted Return	Market Model	Market-Adjusted Return	Market Model	Market-Adjusted Return
(-10, +10)	1.22 (0.38)	0.01 (0.04)	-4.67*** (-2.78)	-6.55 (-3.83)	1.95 (1.01)	0.83 (0.47)
(-10, -1)	-1.55 (-0.60)	-2.16 (-0.90)	-0.75 (-0.72)	-0.70 (-0.67)	0.77 (0.53)	0.79 (0.63)
(+1, +10)	1.95 (1.42)	1.67 (1.27)	-3.51** (-2.45)	-3.97 (-2.73)	0.98 (0.66)	0.03 (0.02)
(+5, -5)	3.97*** (2.74)	3.37 (2.32)	-5.42*** (-4.16)	-5.70 (-4.61)	0.73 (0.44)	-0.30 (-0.19)
(-5, -1)	0.71 (0.78)	0.62 (0.70)	-0.79 (-0.82)	-1.11 (-1.24)	0.65 (0.62)	0.46 (0.45)
(+1,+5)	2.43** (2.31)	2.16 (2.05)	-2.72*** (-2.61)	-2.70 (-2.58)	-0.13 (-0.12)	-0.78 (-0.69)
(-1, +1)	1.95 (2.17)	1.52 (1.63)	-3.41*** (-5.47)	-3.50 (-5.67)	0.23 (0.27)	-0.15 (-0.17)
(-1, 0)	1.50*** (2.80)	1.20 (2.26)	-2.61*** (-3.11)	-2.75 (-3.30)	0.48 (0.75)	0.10 (0.14)
(0, +1)	1.27 (1.56)	0.90 (1.07)	-2.71*** (-5.09)	-2.63 (-5.03)	-0.04 (-0.05)	-0.23 (-0.29)

This table reports the Cumulative Abnormal Returns (CAR) for dividend increase, dividend decrease, and no change in dividends using the market model and the market-adjusted return. *t*-Statistics are for the null hypothesis that the cumulative average abnormal returns are equal to zero. *t*-Statistics are reported in parentheses. **Significant at 5%; and ***significant at 1%.

6.4.5 Efficiency of the Nigerian stock market

This section looks at the speed of share price adjustment to the new information emanating from dividend announcements in order to determine whether or not the Nigerian stock market is efficient in the semi-strong form. The null hypothesis to be tested is that the Nigerian stock market is not efficient in the semi-strong form. Market efficiency is concerned with the speed with which the market reacts to public announcements. A market is said to be efficient in the semi-strong form sense if the market impounds quickly the effect of the announcement of new information into share prices. Therefore, if dividends do

convey price-sensitive information to the market, the share prices should reflect the new information on the day the cash dividend is announced.

The results reported in Table 6.2 show that there is a significant positive abnormal return one day prior to the announcement of an increase in cash dividends. Similarly, there is a significant negative abnormal return a day before the announcement of a decrease in cash dividends (see Table 6.3). With this evidence of price adjustment before the dividend announcement effect, the stock market cannot be said to be efficient in the semi-strong form. This is because the price adjustment may be a result of apparent anticipation by corporate insiders who has privileged information about the impending dividend change. On the other hand, there are significant negative abnormal returns in 2 days following the announcement of a decrease in cash dividends, which indicates a sluggish market reaction to the announcement of dividend decreases. This evidence suggests that it took time for the market to impound the effect of dividend announcements into share prices. Based on the above analysis, it can be concluded that the Nigerian stock market is not efficient in the semi-strong form sense; therefore, the null hypothesis is accepted. These results are at odds with many previous findings, which show that there is no lagging and/or sluggish response to dividend announcements (Petit, 1972; McCluskey *et al.*, 2006; Dasilas and Leventis, 2011), but consistent with the results of prior studies on the semi-strong efficiency of the Nigerian stock market (Olowe, 1998; Adelegan, 2009).

6.5 Conclusion

The research on stock market reaction to dividend announcements is replete with evidence from developed markets; despite the suggestion in the literature that dividend policy is affected by the international context in which firms operate. This chapter provides additional evidence from an emerging market by investigating the stock market reaction to cash dividend announcements for companies listed on the Nigerian stock market over the period 2008-2012. In other words, the chapter examines whether cash dividend announcements contain information relevant to price formation. The Nigerian stock market exhibits remarkable differences from those of the U.S. and other capital markets. First, personal income from dividends is taxable while capital gains are exempt from taxation in

Nigeria, which suggests that dividends may be an important piece of information with which investors can value stocks in Nigeria. Second, there are weak corporate governance practices, which can make dividends an important source of information in pricing shares in Nigeria. Third, the share ownership structure of Nigerian firms is highly concentrated with infrequent trading, which suggests dividend payments can act both as an information-signal and a disciplinary mechanism in Nigeria. Finally, Nigerian listed companies change their dividends frequently, which might affect the information content of dividend announcements in Nigeria.

The results of the study indicate that the Nigerian stock market reacts significantly to cash dividend announcements, implying that dividends do convey price-sensitive information to the market. In line with the tenor of prior research, dividend increases are associated with positive stock price reaction, while dividend decreases are associated with negative stock price reaction. Companies that do not change their dividends report insignificantly positive average abnormal returns. These results lend support to the signalling hypothesis which predicts that stock prices follow the same direction as the dividend change announcements.

In terms of the speed of the share price adjustment to new information emanating from cash dividend announcements, the results of the study suggests that there is lagging response to dividend announcements as there is evidence of price adjustment before the dividend announcement event. On the other hand, during the post-announcement period, the study also finds evidence of sluggish market reaction to dividend announcements as there are significant abnormal returns after the dividend announcement date. Just as in Adelegan (2009), these results suggest that the Nigerian stock market is not efficient in the semi-strong form.

CHAPTER SEVEN

CORPORATE DIVIDEND POLICY IN PRACTICE: THE VIEWS OF NIGERIAN FINANCIAL MANAGERS

7.1 Introduction

The purpose of this chapter is to examine the field practice of dividend policy in an emerging market, such as Nigeria. The motivation to investigate 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 as well as equity ownership structure significantly different from the US and the UK - the two countries where dividend policy has been extensively studied. In Nigeria, dividend income is taxable at the personal level while its equivalent from capital gains is exempt from taxation. Under this tax system, capital gains should be more attractive to shareholders relative to cash disbursements in Nigeria. In addition, the Nigerian equity market exhibits high equity ownership concentration with inactive trading of shares, which may make dividends valuable in solving agency and information problems (Twu and Tsai, 2007). Thus, Nigeria with its untypical tax system and equity ownership structure presents an excellent opportunity to re-examine dividend policy in such a context.

Moreover, the literature has paid very little academic attention to corporate dividend policy research that addresses issues related to the development of emerging stock markets of sub-Saharan Africa, especially Nigeria. The very few studies in this area (e.g. Soyode, 1975; Oyejide, 1976; Ariyo, 1983; Adelegan, 2003) have largely relied on econometric analysis of published financial data. To the best of the researcher's knowledge, there is no prior study that has examined the behavioural aspects of dividend policy in Nigeria using interviews. Frankfurter *et al.* (2004) argued 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 resolve the dividend puzzle, the authors recommend that the cardinal trust of academic research should take a route that can measure motivation and the perceptions underlying dividend decisions.

To provide further insights on managers' perceptions of dividends, this chapter adopts a behavioural approach and builds on the pioneering study on dividend behaviour of firms

conducted by Lintner (1956). Specifically, the chapter employs a semi-structured interview with the financial managers of 21 companies listed on the Nigerian stock market to investigate their perspectives on the role of dividend policy in an emerging market characterised by uncertain economic environment, such as Nigeria. In particular, the interview focused on: (i) the factors that drive dividend decision; (ii) dividend conservatism; (iii) target payout ratio; (iv) the role of the signalling theory of dividend policy; (v) residual dividend policy; and (vi) taxation. By considering the views of the individuals who are actively involved in determining their firms' dividend policy via interviews, the current study significantly enriches the literature on the determinants of dividend policy, especially from the managerial perspectives. In keeping with the research approach taken in chapter 5 of this thesis, the interviews compare the views of managers of financial and non-financial firms where appropriate.

The organisation of the remainder of this chapter is as follows. Section 7.2 provides detailed information about the sample companies selected for interview. Section 7.3 analyses the findings from the interviews while section 7.4 concludes the chapter.

7.2 Sample Companies Selected for Interviews

The purpose of this section is to provide a description of the companies selected for interviews. As discussed in the chapter on research methodology, the interviews seek to update and expand the results and conclusions from the questionnaire survey reported in chapter 5 of the thesis. Thus, the sample firms for the interviews were drawn from the companies that took part in an earlier questionnaire survey administered to the financial officers of all the 191 firms listed on the Nigerian stock market as at mid-June 2012. From a sample of 68 companies that completed and returned their questionnaires, the researcher identified and contacted the financial officers of 25 companies with established patterns of paying dividends, and whose responses to the survey require further discussion and understanding. From this list of companies, the researcher excluded 4 companies for which their financial officers were unable to participate in the interviews, leaving a sample of 21 companies.

The choice of the companies that were 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). The researcher 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 interviews were face-to-face and 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. The managers interviewed included the CFOs, finance director, group finance controller, and finance manager.

Table 7.1: Background Information about the Interviewees' companies

<u>Firm</u>	<u>Sector</u>	<u>Industry Classification</u>	<u>Listings</u>	<u>Cash/Share Dividends</u>
C1	Banking	Financial	NSE/LSE	Cash
C2	Banking	Financial	NSE/LSE	Cash
C3	Agriculture	Non-financial	NSE	Cash
C4	Agriculture	Non-financial	NSE	Both
C5	Industrial goods	Non-financial	NSE	Cash
C6	Insurance	Financial	NSE	Both
C7	Insurance	Financial	NSE	Both
C8	Consumer goods	Non-financial	NSE	Cash
C9	Consumer goods	Non-financial	NSE	Share
C10	Construction/real estate	Non-financial	NSE	Cash
C11	Food & Beverages	Non-financial	NSE	Cash
C12	Food & Beverages	Non-financial	NSE	Both
C13	Food & Beverages	Non-financial	NSE	Share
C14	Insurance	Financial	NSE	Cash
C15	Banking	Financial	NSE	Both
C16	Healthcare	Non-financial	NSE	Share
C17	Healthcare	Non-financial	NSE	Cash
C18	Oil & Gas	Non-financial	NSE/LSE	Both
C19	Banking	Financial	NSE	Cash
C20	Banking	Financial	NSE/LSE	Cash
C21	ICT	Non-financial	NSE	Cash

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/share dividends characteristic was based on responses to the question: "Does your company pay dividends to shareholders?" The acronym NSE stands for Nigerian Stock Exchange, while LSE stands for the London Stock Exchange.

Table 7.1 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 companies are dividend payers and twelve of these reported paying cash dividends. Three of the companies paid a share dividend, while six of the companies paid both cash and share dividends during the period. The table also reveals that four of the companies had listings on both the Nigerian Stock Exchange (NSE) and the London Stock Exchange (LSE). Eight of the companies 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.

7.3 Empirical Results

The discussion of the results of the interviews with the 21 financial managers of Nigerian listed companies is presented in six sub-sections as follows: (i) factors that drive dividend decision, (ii) dividend conservatism, (iii) target payout ratio, (iv) residual dividend policy, (v) market signalling, and (vi) taxation.

7.3.1 Factors that drive dividend decision

All the interviewees perceive current earnings as the main factor that drives a firm's 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. The evidence of current earnings as the most important factor in crafting a firm's dividend policy supports the works 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 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 was the most 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 show 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 attach 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.

Finally, 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 suggest that managers of Nigerian non-financial 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 attach 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).

7.3.2 Dividend conservatism

Based on an extensive field study of the dividend policy of companies in the USA, 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 show 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, noted 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, noted that “we try to avoid cutting the dividends per share”. This apparent reluctance by managers to cut dividends is consistent with the findings reported for U.S. firms by Brav *et al.* (2005) and for UAE firms by Chazi *et al.* (2011).

A unique observation of the present study that was not evident in the questionnaire survey reported in chapter 5 of the thesis is that all of 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 show that managers of financial firms believe 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 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.

The interviewees’ attitude to the notion of dividend conservatism also depended upon the way in which dividend changes respond to sustainable changes in earnings. Discussions with the respondents revealed that a sustainable shift in earnings is an important determinant of dividend decisions, especially so in the case of non-financial firms. In this context, interviewee C3, the finance manager of a firm from the agricultural sector, summed up the position of non-financial firms as follows:

We consider our earnings when making the dividend payout decision. If our earnings are not enough, we will not be able to pay cash dividends to shareholders. So, the level of our earnings influences our ability to pay dividends to shareholders.

In addition, the interviewees noted that the stability of future earnings is an important factor influencing dividend policy. This view is consistent with the high level of importance that interviewees attach to earnings as the main factor influencing their firm’s dividend policy.

Overall, the interviews with the financial managers suggest that Nigerian firms exhibit 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.

7.3.3 Target payout ratio

Lintner (1956) identifies 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 show 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 U.S. 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 show 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, 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 believe 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 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 dividend payout is influenced by the level of current earnings, the stability of earnings, and liquidity consideration such as the availability of cash. Moreover, the variable targeted by Nigerian companies when setting the amount of dividends to pay to their shareholders appeared to be the dividend per share, rather than the target payout ratios.

7.3.4 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 (Dhanani, 2005; 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 modern 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 pursue 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 believe 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 managers of Nigerian listed companies attached 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.

7.3.5 Market Signalling

Miller and Modigliani (1961) argue that in a frictionless capital market, a firm's dividend policy will not affect its value. One of the assumptions of the dividend irrelevance argument is that information about companies is costless and universally available to all investors. This assumption implies that all market participants are symmetrically informed. For this reason, shareholders are indifferent to the dividend policy adopted by a firm, and in this context, Black (1976) suggested that firms should eliminate dividend payments to shareholders completely. However, in the real world, information asymmetry exists between managers and shareholders, because managers possess superior information about a firm's current situation and future prospects than the shareholders of a firm. Given the presence of information asymmetry between managers and outside shareholders, the signalling theory argues 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, p.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 (Aharony and Swary, 1980; McCluskey *et al.*, 2006; Al Yayhaee *et al.*, 2011). Part of the interviews focus on the signalling hypothesis of dividend announcements in Nigeria.

The findings from the interviews show that financial managers of Nigerian firms believe that dividend policy convey 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, were typical when noting 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 policy to make their firms look better than their competitors. The interviewees from financial firms believe 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 U.S. firms by Brav *et al.* (2005), who documented no evidence that payout policy is used to separate a given firm from its competitors.

7.3.6 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 capital gains are exempt 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 share 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 firm's 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 U.S. 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 believe that taxation was not an important factor that influences the dividend decision of their companies.

7.4 Conclusion

This chapter employed an in-depth interview with the financial managers of firms listed on the Nigerian stock market to examine the field practice of dividend policy in an emerging market where personal income from dividends is taxable, while its equivalent from capital gains are totally exempt from taxation. The chapter also examined whether the perceptions of managers of financial versus non-financial firms differ on various dividend policy issues. The main contribution of this chapter is that it updates and expands the questionnaire-based study reported in chapter 5. In addition, by comparing the perspectives of managers of financial and non-financial firms on various dividend policy issues, this chapter provides a unique perspective on industry-related dividend effect in the 21st century. The evidence reinforces some earlier findings while not supporting others.

The evidence from the interviews provides support for the notion that dividend policy is conservative as predicted by Lintner (1956), and is consistent with recent emerging market evidence reported by Chazi *et al.* (2011) for UAE firms and Khan *et al.* (2011) for Pakistani firms. From managerial perspective, dividend conservatism is rooted in the market's asymmetric reaction to dividend increases and decreases. Indeed, the discussions revealed that Nigerian firms are reluctant to reduce dividends and typically determine their dividend payout based on current earnings, the stability of earnings and liquidity considerations such as the availability of cash. However, in contrast to the predictions of Lintner's (1956) model, most Nigerian firms do not have target payout ratios or formal speed of adjustment processes; instead, the variable targeted by Nigerian firms when setting the dividend level appeared to be the dividend per share.

In contrast to the predictions of Miller and Modigliani (1961), dividends are not considered as a residual cash flow in Nigeria. Nigerian managers determine the size of their dividend payout and their investment needs simultaneously and when internal funds are not sufficient to meet these needs, they finance the shortfall with debt. The interviews documented evidence of a broad interdependency among investment, financing and dividend decisions in Nigeria. Indeed, Nigerian firms tend to 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 respect to signalling explanation for paying dividends, discussions with the interviewees revealed that managers of Nigerian firms believe in the signalling effect, where dividends may be used to signal the future prospects of the firm. In particular, respondents from financial firms were generally supportive of 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. Moreover, the dividend-paying firms stated that they use dividends to make their firms look better than their competitors.

In terms of the impact of taxation on firm's dividend decision, the interviews reveal that taxes are immaterial when making the dividend decision by companies in Nigeria. Perhaps, one of the reasons for the unanimity among the respondents about this issue is that the Nigerian equity market is dominated by investors who favour dividend income to capital appreciation because of the need of physical cash to take care of their immediate needs. Therefore, dividends are clearly attractive to shareholders relative to capital gains, despite the tax consequences associated with such a disbursement in Nigeria.

CHAPTER EIGHT

CONCLUSION

8.1 Introduction

This thesis investigated managerial perspectives on dividend policy and the impact of dividend announcements on share prices of companies listed on the Nigerian stock market. In other words, the thesis examined whether cash dividend announcements is relevant to firm valuation in Nigeria. Very little work has been conducted on dividend policy in emerging stock market of Nigeria, despite the importance of this market in sub-Saharan Africa and its distinctive institutional characteristics. The few studies that were conducted using Nigerian data have either employed regression analysis to examine the determinants of dividend policy or were conducted more than 30 years ago (Uzoaga and Alozienwa, 1974; Inanga, 1975; Soyode, 1975; Oyejide, 1976; Odife, 1977; Ariyo, 1983; Izodonmi, 1996; Olowe, 1998; Adelegan, 2003; Osuala, 2006; Campbell and Ohuocha, 2011). There is no prior study that has examined the behavioural aspect of dividend policy using surveys in Nigeria. Given the untypical corporate taxation system in Nigeria, where personal income from dividends is taxable, while capital gains are exempt from taxation, an investigation of why Nigerian listed companies pay dividends despite the tax consequences associated with such a disbursement is warranted.

In attempting to establish how Nigerian corporate managers make their dividend decision and the impact of cash dividend announcements on share prices of companies listed on the Nigerian stock market, the thesis employed a mixed methods research design, comprising of both quantitative and qualitative approaches. In particular, three separate studies were conducted, using a questionnaire survey, a market-based event study methodology, and a semi-structured interview. The questionnaire survey sought the perceptions of corporate managers on the factors that drive dividend decision and the relevance of dividend policy to firm value in Nigeria. The event study examined the stock market reaction to the announcements of cash dividends employing data from 102 listed companies that made 252 cash dividend announcements over the period 2008-2012. Finally, interviews were conducted with 21 financial managers about their perspectives on various dividend policy issues. Basically, the interviews were designed to probe further the responses from the questionnaire survey.

The remainder of this chapter is organised as follows. The main findings of the thesis are discussed in section 8.2. Section 8.3 evaluates the contribution of this study to both theory and practice of dividend policy while section 8.4 highlights the limitations of the study. Finally, Section 8.5 makes suggestions for future research in this relatively unexplored area.

8.2 Summary of Key Findings of the Thesis

The thesis investigated the managerial perspectives on dividend policy and the stock market reaction to cash dividend announcements in Nigeria. The main objectives of this study were to: (i) investigate the perspectives of Nigerian corporate managers on the factors that drive the dividend decision of their companies; (ii) examine the impact of cash dividend announcements on share prices in the Nigerian context; and (iii) examine the speed of share price adjustment to dividend announcements in order to determine whether or not the Nigerian stock market is efficient in the semi-strong form. The study accomplished these objectives using a mixed methods research design consisting of a questionnaire survey, an event study methodology employing the market model and a semi-structured interview. A number of key findings emerged from the analysis of the results of these investigations.

First, the analysis of the findings from the questionnaire survey and the interviews suggest that despite the differences in institutional environment between emerging and developed markets, the dividend-setting process in Nigeria companies is similar in many respects to those in developed markets. Specifically, the findings provide support for the notion that dividend policy is made conservatively as predicted by Lintner (1956) in that Nigerian companies are reluctant to cut dividends and typically determine their current dividend payout based on current earnings, stability of earnings, and liquidity considerations such as the availability of cash. Yet, the results of this study indicate the existence of industry effects in the perceptions of managers from financial firms and non-financial firms on some of the factors that drive dividend decisions in Nigeria. Specifically, managers from financial firms gave more support to stability of earnings as a factor that drives their dividend decision than their counterparts from non-financial firms. In contrast, managers from non-financial firms considered liquidity as the main factor influencing their firms' dividend policy.

Second, the findings from the questionnaire and interview suggest that majority of Nigerian listed companies do not have a target payout ratio or formal speed of adjustment processes; instead, they target the dividend per share when setting the dividend payout levels. This finding is consistent with recent evidence reported by Chazi *et al.* (2011) and Khan *et al.* (2011) in the emerging stock markets of UAE and Pakistan respectively. However, the results of the study indicated the existence of industry effects in that the perceptions of managers from financial and non-financial firms differ on this issue. The views of the respondents from non-financial firms contrasts strikingly with the predictions of Lintner's (1956) theoretical model of dividend policy which suggests that the payout ratio is the starting point of most dividend decisions after earnings. In particular, the respondents from non-financial firms indicated that they are less concerned about setting a target payout ratio; rather, they set their dividends based on the level of current earnings and that the variable targeted when setting their dividend disbursement level is the dividend per share. In contrast, some respondents from financial firms do not appear to share this view. More than forty-three percent of the managers from financial firms that responded to the questionnaire survey supported the notion that firms should have a target payout ratio. The interviews reveal that the primary concern of the respondents from financial firms that spoke in favour of the notion that target payout ratio is important in dividend decision appears to be the realization of smooth growth in their firm's dividends in relation to expected cash available over time.

Third, with respect to whether dividends are determined as a residual in Nigeria, the findings of this study suggest that dividends are not considered a residual cash flow in Nigeria. Miller and Modigliani (1961) argued that dividend policy is entirely separate from the financing and investment policies of the firm. However, contrary to their theoretical assumption, managers of Nigerian listed companies consider the dividend policy as an essential part of business strategy, which includes both investment and financing decisions. The discussion with the interviewees reveals that managers of Nigerian listed companies believe that adopting a dividend policy that prioritize dividends and growth will attract more investors to their firms. There was no difference in the views of respondents from financial versus non-financial firms on this issue.

Fourth, the evidence from this study indicates that corporate managers of Nigerian companies believe that dividends convey private information to investors about the current and prospective performance of the firm. Yet, significant differences emerged in the attitude of managers from financial firms and non-financial firms in this regard. The corporate managers of financial firms expressed much stronger support for the view that dividends signal insider's private information about the future prospects of a firm than their counterparts from non-financial firms. Although respondents from both groups indicated that they are reluctant to reduce dividends because investors consider the dividend to be very important when appraising their shares, a distinctive observation of the present study is that all the interviewees from financial firms stated that they are particularly aware of the negative signalling effect associated with a dividend cut, whereby investors are less attracted to the shares of companies that decrease their dividends. In addition, respondents from financial firms believe that dividend payments can be used to separate firms from their counterparts in the same industry because investors see dividend payments as an indicator that a company is in sound financial health.

Fifth, in terms of the impact of taxation on firm's dividend decision, the findings from the questionnaire and interview suggest that taxation was not an important factor that influences the dividend decision of Nigerian companies. Majority of the respondents stated that they are unconcerned about the taxation of dividends since it was the shareholders liability. Despite the known tax consequences associated with dividend payments in Nigeria, majority of the listed companies continue to pay dividends to shareholders. A possible explanation of the unanimity among the respondents about this issue is that the Nigerian equity market is dominated by investors who favour dividend income to capital appreciation because of the need of liquidity to take care of their immediate needs. In addition, the transaction costs of selling shares may also be responsible for this result.

Six, the results of the event study indicate that the Nigerian stock market reacts significantly to cash dividend announcements, implying that dividends do convey price-sensitive information to the market. The market reaction was more evident on the dividend announcement date. In particular, companies that announced dividend increases experienced significant positive share price reaction, while companies that announced dividend decreases experienced significant decline in share prices. Companies that did not

alter their dividend payment reported insignificant positive abnormal return on the dividend announcement date. This findings support the notion that dividends contain information relevant to price formation and is consistent with the results of prior studies which show that stock prices follow the same direction as the dividend change announcements (Petit, 1972; Aharony and Swary, 1980; Lonie *et al.*, 1996; Al-Yahyaee *et al.*, 2011).

Finally, the results of the event study suggest that the Nigerian stock market is not efficient in the semi-strong form. An examination of the speed of share price adjustment to the information emanating from cash dividend announcements indicated that the Nigerian stock market do not respond quickly and efficiently to the corporate news contained in cash dividend announcements. Specifically, there were evidences of price adjustment before the announcement of both increases and decreases in cash dividends. These evidences suggest that there is some information leakage into the market. In a similar vein, the study documented sluggish market reaction after the announcement of dividend decreases, implying that it took time for the market to impound the effect of the dividend announcements into share prices. Since there is evidence of both lagging and sluggish response to cash dividend announcements in Nigeria, then the stock market cannot be said to be efficient in the semi-strong form sense. This finding is in line with those reported by Adelegan (2009) in an empirical investigation of the stock market reaction to dividend announcements in Nigeria.

8.3 Contributions and Implications of the Thesis

The significance of any research activity depends on the amount of contribution it makes to the body of knowledge under investigation and its relevance in addressing practical issues. In other words, for a research to be practically acceptable, it must strike a balance between rigor and practice. The research in this thesis makes a number of valuable contributions to knowledge and practice of dividend policy, especially in the context of emerging markets. These contributions are discussed below:

8.3.1 Contribution to knowledge

This thesis makes a novel contribution to the growing body of corporate finance literature in various ways. First, this thesis adds to the very little academic research that has examined the stock market reaction to dividend announcements in the context of an “emerging” rather than the “developed” market. To date, empirical studies of the impact of dividend announcements on share prices have been bias in favour of countries with developed capital markets (e.g. Petit, 1972; Charest, 1978; Aharony and Swary, 1980; Easton, 1991; Lonie *et al.*, 1996; McCluskey *et al.*, 2006; among others). As a result, there is little evidence on whether these dividend effects are also prominent in emerging markets where the tax regime and/or institutional and economic characteristics are significantly different from what obtains in developed markets. The results of this thesis show that in an emerging market with highly concentrated shareholdings and limited disclosure of information such as Nigeria, dividends may be the one source of information that allows investors to evaluate management’s expectations and confidence as to the future performance of a firm. The results of this thesis therefore show that the dividend effects in countries with developed markets are also prominent in emerging markets.

Second, this thesis also made significant contribution to the literature on industry-related dividend effects by investigating whether the perceptions of managers of Nigerian financial and non-financial firms differ on various dividend policy issues. Ever since Lintner (1956) asserted that an industry effect may influence dividend policy, only few studies have examined the differences in the perceptions of managers of financial and non-financial firms on dividend policy (Baker *et al.*, 2001; Baker *et al.*, 2008). The results of this thesis show that there are significant differences in the importance that managers of financial versus non-financial Nigerian firms attach to some of the factors that drive dividend decision and on statements involving the signalling explanation for paying dividends. For example, while managers of financial firms consider stability of earnings as the next most important influence on dividend policy after current earnings, their counterparts from non-financial firms consider liquidity as the main factor that drives their dividend decision after earnings. Moreover, managers from financial firms have stronger incentives to send reliable signals about future profitability through dividend payouts than their counterparts from non-

financial firms. This study therefore updates and extends prior studies on industry-related dividend effect.

Finally, the use of a behavioural approach (questionnaire and interviews) in the investigation of the factors that drive dividend decision provided an interesting insight into the dynamics of dividend policy which were missing in prior literature in Nigeria. To the best of the researcher's knowledge, this study is the first survey of managerial perspectives on dividend policy applied to the Nigerian context. The behavioural aspects of this study reveal that managers of Nigerian companies use dividend policy to outperform other firms in the same industry. Thus, the use of questionnaire and interviews were helpful because it enabled the researcher to ascertain the motivation behind dividend payments and the perceptions underlying this motivation, thus providing insights unavailable through publicly available sources. This study therefore contributes to the extant surveys conducted to explain corporate dividend policy in practice (Lintner, 1956; Baker *et al.*, 1985; Brav *et al.*, 2005) for US firms, Dhanani (2005) for UK firms, and McCluskey *et al.* (2007) for Irish firms.

8.3.2 Contribution to Practice

The research on corporate dividend policy lends its relevance to practice because dividend decision is considered one of the most vital decisions that management make. The findings of this thesis are of practical relevance to managers, investors, and investment analysts interested in companies listed on the Nigerian stock market as they reveal the extent to which the shares reflect fundamental information from corporate announcements. In addition, the research in this thesis is also important to the regulators of the Nigerian stock market in making well-versed decision regarding dividend policy in Nigeria.

For the managers, their flexibility to invest in projects depends on the level of dividend distributions as more dividends mean fewer funds for investment purposes. The findings of this thesis is useful to corporate managers of Nigerian listed companies as it will help them to maximize the value of their companies by meeting the preferences of their investors. In addition, the research in this thesis will help corporate managers of Nigerian listed companies learn how their competitors make their dividend policy decision, which would help them maintain competitiveness by benchmarking their practices against the market.

The research in this thesis is also of practical importance to investors. This is because investors see dividend as not only a means of regular income, but also as an important input in the valuation of a firm. The findings of this thesis would help Nigerian investors understand the mechanics of the dividend payout process and the effect of the payout decision on share prices. This knowledge will enable Nigerian investors to design better investment strategies, such as timing their buying and selling decision based on dividend declarations. In addition, the findings of this thesis will help investment analysts to enhance their equity research, profitability expectations and ability to predict the impact of dividend announcements on share prices.

The findings of this study will also help the regulators of the Nigerian stock market in making informed decision regarding dividend payout policies. By understanding the factors that affect the dividend policy of Nigerian listed companies, regulators can issue more effective regulations towards the protection of investors. Overall, the research in this thesis will help improve the understanding of managers, investors, analysts, and regulators regarding the dividend setting process in Nigeria. This increased level of understanding is expected to reduce market volatility resulting from misinterpretation and false expectations, thereby leading to higher level of stability in the economy.

8.4 Research Limitations

Although this thesis represents a novel attempt at a comprehensive investigation of the dividend policy and stock market reaction to dividend announcements in Nigeria, some obvious limitations exist. First, the questionnaire survey instrument could be prone to questionnaire method bias in the form of misrepresentation and misinterpretation (Dong *et al.*, 2005). In addition, the questionnaire could also be prone to acquiescence, central tendency and social desirability biases which could result in the usage of scale measure (Dawes, 2008). The acquiescence bias is the tendency to agree with the questions asked, while the central tendency bias is the tendency of respondents to give extreme answers. On the other hand, the social desirability bias is the tendency to which the respondent agrees with socially desirable answers. However, these limitations were taken into consideration during the questionnaire development phase. The study also employed a large sample in its

analysis, which was relatively above the sample used in similar studies. Another limitation of the questionnaire results from the inconsistencies in the responses to the questions posed. However, the interviews were designed to clarify some of the discrepancies in the questionnaire survey responses.

Second, this thesis did not include stock dividends and simultaneous cash and stock dividends announcements in the data used in the empirical investigation of stock market reaction to dividend announcements in Nigeria. The information content of dividend announcements documented in chapter six of this thesis considers only cash dividend announcements made without any other contemporaneous announcements around the announcement date. The exclusion of these events is one of the main deficiencies of this thesis as recent empirical evidence suggests that share prices may react differently when such events are included in a sample (Akbar and Baig, 2010). In addition, given the distinctive taxation structure in Nigeria, where capital gains are exempted from taxation during the period of this study, the exclusion of stock dividends may have affected the findings of this study. Moreover, only 252 firm-year observations over the relatively short period of 5 years (2008-2012) were employed for the event study. However, this period was selected because it was a reflective of all economic conditions- recession, recovery and boom in the Nigerian economy and also due to data availability. It is expected that the use of mixed methods research approach in this thesis compensates for the deficiencies of a single method.

Finally, although the interviewees were selected so as to be representative, only managers of 21 companies were interviewed. As such, the findings from the interviews may not be totally generalizable, as the respondents cannot be said to be a representative sample of Nigerian listed companies. Closely related to this is that in an interview-based research, the participants are necessarily a self-selecting group. Nonetheless, the researcher deliberately chose the firms with established patterns of paying dividends in order to provide generalizability. In addition, the norm in some companies is that information leakage to outsiders may cause possible competitive threats to the organization. Thus, interviewees would naturally hesitate to provide information about their practices in an interview. This confidentiality issue is a major limitation of this study since interviewees may not reveal profitability and dividend issues. This issue of confidentiality was dealt with by re-assuring

the interviewees that their identity and that of their organizations will not be revealed in any published work emanating from this study. This issue was also tackled by presenting an official letter from Lancashire Business School assuring interviewees of their anonymity. Moreover, there may be subjectivity or bias in the analysis of the interview data since majority of the interviews was not taped. In these cases, manuscript notes were taken during the interview.

8.5 Future Research

Notwithstanding the acknowledged limitations of the study, this thesis remains the most comprehensive investigation of the “dividend puzzle” applied to the Nigerian context to date. This study adds to the very limited academic research that has investigated the behavioural aspect of dividend policy in an emerging market; it is the first study on managerial perspectives on dividend policy in Nigeria. Therefore, this research should act as a foundation for future research in this area.

An important area where future research may be fruitful would be to examine the impact of stock dividends on share prices in Nigeria. Since the analysis on market reaction to dividend announcements documented in this thesis was based on cash dividends, the study did not consider the information contained in stock dividend announcements. As discussed earlier, the Nigerian capital market is characterised by a distinctive taxation system where capital gains are totally exempted from taxation during the period of this study. In this system, the literature suggests that investors would prefer to receive profits in the form of capital gains than dividends. Moreover, the result of recent research has suggested that there is an increasing popularity of stock dividends in Nigeria in recent years (Campbell and Ohuocha, 2011). Therefore, future research could be done to investigate whether the Nigerian stock market reacts to stock dividend announcements and to ascertain the nature of the information conveyed by stock dividends in Nigeria.

Future research could also examine the impact of cash dividend announcements on share prices in Nigerian employing data from a longer time-span. As earlier stated, the present study examined the stock market reaction to cash dividend announcements in Nigeria using

a 5-year data (i.e. daily share prices and cash dividends data from 2008 to 2012). It is expected that an analysis conducted with larger sample would achieve more generalizability. In addition, future research could examine the relationship between ownership concentration and market reaction to dividend change announcements. Given that the ownership structure of Nigerian companies is highly concentrated, an examination of the impact of ownership structure on dividend policy merits empirical investigation.

Furthermore, since the results of previous studies suggest that both dividend and earnings announcements induce abnormal returns in share prices (Kane *et al.*, 1984; Lonie *et al.*, 1996; McCluskey *et al.*, 2006; amongst others), future research should be directed to the examination of the impact of complex signals on share prices in Nigeria. This is because a usual corporate practice in Nigeria is the joint announcement of annual dividends with those of earnings. The joint announcement of earnings and dividends makes it difficult to determine which of the corporate announcements is responsible for the abnormal returns in share prices. Therefore, an examination of the interaction effect between concurrently announced dividends and earnings in Nigeria is warranted. This will enable researchers to determine whether abnormal returns in share prices in Nigeria can be attributed to dividend announcements alone or to both dividend and earnings announcements.

Finally, since the findings of the current study suggests that some earlier findings about managerial views on dividend policy in the developed markets also prevail in emerging markets, future research should be directed at the examination of the extent to which the views of managers in other emerging market countries in Africa and beyond are consistent with those found to exist in Nigerian stock market. In addition, further research could usefully extend this analysis and establish whether the findings of this study, especially regarding the signalling hypothesis exist in other countries with relatively small stock markets, but where the exchange is in an “emerging” rather than “developed” country. The investigation of the dividend decision and impact of dividend announcements on share prices in other emerging markets of the world, especially those in sub-Saharan Africa would allow for comparability with this research. Moreover, future research could aim to achieve more generalizability by including larger sample for the event study as well as a higher number of respondents in the interviews.

APPENDICES

APPENDIX 5.1-LETTER TO QUESTIONNAIRE RESPONDENTS



QUESTIONNAIRE SURVEY

14th June, 2012

Dear Respondent,

Subject: Dividend Policy Decision in Nigerian Listed Companies

Mr Friday Kennedy Ozo of the Institute of Global Finance and Development (IGFD) at the Lancashire Business School of the University of Central Lancashire United Kingdom is undertaking a research project on the topic: **“An Investigation of the Dividend Policy Decision in Nigerian Listed Companies”**. The Nigerian Stock Exchange has indicated its support for this research.

A vital aspect of this study requires us to obtain the views of your company and other companies listed on the Nigerian Stock Exchange on the factors that drive the dividend payment decision in the Nigerian context. Due to your education, practical training and experience, you have been selected to give us your views on the subject.

This research will help you and your counterparts in the sub-Saharan Africa maximize the value of your companies by meeting the preferences of your investors. In addition, you will learn how your competitors make the payout decisions, which will help you maintain your competitiveness by benchmarking your practices against the market.

Please help by completing and returning the enclosed questionnaire. The questionnaire has been designed to take not more than twelve minutes to complete. Please be assured that only research members will be able to view your responses. Results of the survey will only be used for the sole purpose of academic research. All respondents' identities will be kept **strictly confidential** as no company details will be divulged.

To ensure that you do not incur any mailing expenses; a stamped, self-addressed return envelope is enclosed. We will be happy to send you an executive summary of the results upon completion. To obtain the results of this study, please indicate to this effect by ticking the box on page four of the questionnaire.

All completed questionnaires received will be entered in a draw for a case of Champagne. The draw will take place on 30th July 2012.

Thank you for taking time from your busy schedules to complete this questionnaire.

Yours Sincerely,

Friday Kennedy Ozo
Doctoral Candidate,
Institute of Global Finance and Development,
University of Central Lancashire, UK.
Email: fkozo@uclan.ac.uk.

Prof. Thankom G. Arun
Professor of Development Finance & Public Policy
Institute of Global Finance & Development,
University of Central Lancashire, UK.
Email: tgarun@uclan.ac.uk

APPENDIX 5.2- FOLLOW-UP LETTER TO QUESTIONNAIRE RESPONDENTS



QUESTIONNAIRE SURVEY

14th August 2012

Dear Respondent,

RE: Dividend Policy Decision in Nigerian Listed Companies

We are yet to receive your reply to our letter of 14th June, 2012.

Your perception of the dividend policy decision in your company is vital to the completion of our research.

Please kindly complete and return the enclosed questionnaire. Your identity and that of your organisation is strictly confidential. The results of the study will only be used for the sole purpose of academic research. A self-addressed return envelope is enclosed.

All completed questionnaires received will be entered in a draw for a case of Champagne. The draw has now been shifted to 30th September 2012 to enable you send in your completed questionnaires.

We will be happy to send you a summary of the results of this study upon completion. To obtain the results of this study, please indicate to this effect by ticking the box on page four of the questionnaire.

Thank you for taking time from your busy schedules to complete this questionnaire.

Yours Sincerely,

Friday Kennedy Ozo
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Email: fkozo@uclan.ac.uk.

Prof. Thankom G. Arun
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APPENDIX 5.3- QUESTIONNAIRE SURVEY INSTRUMENT

Section 1: Factors that drive corporate dividend decision

By checking (X) in the corresponding column, please indicate the extent to which you agree/disagree with each of the statement about the factors influencing dividend policy.

Factors influencing dividend policy decision of companies	Strongly Disagree	Disagree	Uncertain	Agree	Strongly Agree
<i>A company should determine its current dividends based on.....</i>					
F1. Availability of profitable investment opportunities.	<input type="checkbox"/>				
F2. The pattern of past dividends.	<input type="checkbox"/>				
F3. Cash flow/ liquidity constraints such as the availability of cash.	<input type="checkbox"/>				
F4. The level of current earnings.	<input type="checkbox"/>				
F5. The current degree of financial leverage.	<input type="checkbox"/>				
F6. Stability of earnings.	<input type="checkbox"/>				
F7. The level of expected future earnings.	<input type="checkbox"/>				
F8. Concern about affecting the share price.	<input type="checkbox"/>				
F9. The preference of shareholders such as the need for dividend income.	<input type="checkbox"/>				
F10. The dividend distributions of competitors	<input type="checkbox"/>				
If you have any further comments on the factors that drive the dividend decision of your company, please include them here.					

Section 2: Relationship between dividend policy and firm value

By checking (X) in the corresponding column, please indicate the extent to which you agree/disagree with the following statements about the dividend setting process and the relationship between dividend policy and firm value.

Panel A: Dividend Setting process	Strongly Disagree	Disagree	Uncertain	Agree	Strongly Agree
S1. A firm should avoid making changes in the dividend rate that might have to be reversed in the future.	<input checked="" type="checkbox"/>				
S2. A firm should desire to maintain a target dividend payout ratio and periodically adjust this ratio towards the target.	<input type="checkbox"/>				
S3. A firm should strive to maintain an uninterrupted record of dividend payments.	<input type="checkbox"/>				
S4. Firms view cash dividends as residual after financing investment from earnings.	<input type="checkbox"/>				
S5. The market places greater value on stable dividends than stable payout ratio.	<input type="checkbox"/>				
	<input type="checkbox"/>				
Panel B: Dividend policy and firm value	Strongly Disagree	Disagree	Uncertain	Agree	Strongly Agree
S6. A change in a firm's dividend policy affects its value.	<input type="checkbox"/>				
S7. A firm should design its dividend policy to produce maximum value for its shareholders.	<input type="checkbox"/>				
S8. An optimal dividend policy strikes a balance between current dividend and future growth that maximizes share value.	<input type="checkbox"/>				
S9. A firm's investment, financing and dividend decisions are interrelated.	<input type="checkbox"/>				
S10. A firm's dividend policy affects its cost of capital.	<input type="checkbox"/>				
S11. A firm's dividend policy affects its share price.	<input type="checkbox"/>				
Please comment generally on the dividend setting process and the relevance of dividend policy to firm value especially in the context of an uncertain economic environment, such as Nigeria.					

Section 3: Explanations of for paying dividends

By ticking (X) at the appropriate box, please indicate the extent to which you agree/disagree to the following statements that explain why companies pay dividends to shareholders.

	Strongly Disagree	Disagree	Uncertain	Agree	Strongly Agree
<u>Panel A: Dividends and signalling</u>					
S12. Dividend announcements provides subtle signal about the state of affairs of the business.	<input type="checkbox"/>				
S13. Investors generally regard dividend changes as a signal of future earnings prospects.	<input type="checkbox"/>				
S14. An unexpected increase in dividends will generally lead to a rise in share price.	<input type="checkbox"/>				
S15. An unexpected decrease in dividends will generally lead to a fall in share price.	<input type="checkbox"/>				
S16. Investors use dividend announcements as information to assess firm's share value.	<input type="checkbox"/>				
S17: A firm should adequately disclose to investors its reasons for changing its cash dividend.	<input type="checkbox"/>				
<u>Panel B: Dividends and taxes</u>					
S18. A firm should be responsive to the dividend needs of its shareholders.	<input type="checkbox"/>				
S19. Investors generally prefer to invest in firms whose dividend policies suit their tax status.	<input type="checkbox"/>				
S20. Investors in high tax brackets are attracted to low dividend shares.	<input type="checkbox"/>				
S21. Investors in low tax brackets are attracted to high dividend shares.	<input type="checkbox"/>				
S22. The introduction of the 10% dividend withholding tax has made dividend payments to shareholders less attractive.	<input type="checkbox"/>				
<u>Panel C: Dividends and agency costs</u>					
S23. The payment of dividends acts as a bonding mechanism to encourage managers to act in the interest of outside shareholders.	<input type="checkbox"/>				
S24. The payment of dividends forces a firm to seek external financing which subjects the firm to the scrutiny of investors.	<input type="checkbox"/>				
<u>Panel D: Dividends and Bird-in-the-hand</u>					
S25. Investors prefer cash dividends today to uncertain share appreciation.	<input type="checkbox"/>				
S26. Investors perceive cash dividends to be less risky than capital gains.	<input type="checkbox"/>				

Section 4: Administration of Dividend Policy

Please tick (X) at the appropriate box.

1. Who is the most influential in developing the dividend policy approved by the Board of Directors?

CEO CFO Other

2. How often does your company finally re-examine its dividend policy?

Quarterly

Annually

Other

3. Does your company pay dividends to shareholders each year?

Yes No

4. Has the level of dividends paid changed since the previous year?

Yes No

5. Does your company have an explicit dividend target ratio (a long-term desired dividend earnings ratio)?

Yes No Don't know

6. Please indicate the main activity of your company

Agriculture Food and Beverages Financial Services Oil and Gas

Construction and Real Estate Consumer Goods Health care ICT

Industrial goods Natural resource Utilities Services

7. Please indicate your position in your organisation

CEO CFO Finance Director Company Secretary

Other Please specify.....

8. Please indicate whether you would like us to send you an executive summary of the results of this research.

Yes No

Please comment generally about the dividend policy decision of your company.

Thank you for completing this questionnaire

APPENDIX 6.1-SAMPLE FIRMS

The Cash Dividend Announcement Dates over the Period 2008-2012

SN	Name of Company	2008	2009	2010	2011	2012
1	7UP BOTTLING COMPANY	03-Oct-08	11-Sep-09		12-Aug-11	29-Jun-12
2	ABBEY BUILDING SOCIETY				17-Jun-11	
3	ACADEMY PRESS		14-Aug-09	06-Aug-10	28-Jul-11	29-Jun-12
4	ACCESS BANK	01-Aug-08	16-Jun-09		25-Mar-11	
5	AG LEVENTIS		24-Apr-09	14-May-10	15-Apr-11	05-Apr-12
6	AIICO INSURANCE				03-Jun-11	18-May-12
7	AIRLINE SERVICES & LOGISTICS		17-Apr-09	04-Jun-10	05-Jul-11	
8	AFRICAN PAINTS		03-Jul-09			
9	ASHAKA CEMENT		05-Jun-09		15-Apr-11	05-Apr-12
10	ASO SAVINGS & LOANS	01-Aug-08	06-Oct-09			
11	ASSOCIATED BUS COMPANY	08-Aug-08				
12	BECO PETROLEUM			26-Apr-10		
13	BENUE CEMENT			09-Apr-10		
14	BERGER PAINT		05-May-09	21-May-10	21-Apr-11	05-Apr-12
15	BETA GLASS			12-Apr-10		
16	BIG TREAT		05-Jun-09			
17	BOC GASES	30-May-08	03-Apr-09	04-May-10	01-Apr-11	
18	C & I LEASING	08-Aug-08	31-Jul-09	08-Sep-10		
19	CAPABELTO	01-Aug-08				
20	CAPITAL HOTELS		13-Jul-09	24-Mar-10	01-Apr-11	
21	CEMENT COMPANY OF NORTHERN NIGERIA		04-Sep-09	08-Jun-10		20-Apr-12
22	CHAMS		20-May-09			
23	CHEMICAL AND ALLIED PRODUCTS		08-May-09		08-Apr-11	
24	CHEVRON OIL	05-Jun-08				
25	CONOIL	01-Aug-08	20-Nov-09	13-Sep-10	20-May-11	
26	CONTINENTAL REINSURANCE		05-May-09	18-Jun-10	21-Apr-11	05-Apr-12
27	CORNERSTONE INSURANCE	26-Sep-08				
28	COURTVILLE BUSINESS SOLUTIONS		24-Apr-09	14-May-10	18-May-11	
29	CRUSADER	30-Jul-08				

30	CUSTODIAN AND ALLIED INSURANCE		30-Apr-09	21-May-10	21-Apr-11	13-Apr-12
31	CUTIX	05-Sep-08	24-Sep-09		12-Aug-11	14-Sep-12
32	DANGOTE CEMENT				08-Apr-11	
33	DANGOTE FLOUR MILLS			13-Sep-10	12-Aug-11	25-May-12
34	DANGOTE SUGAR	29-Aug-08	03-Jun-09	14-Jul-10	21-Apr-11	20-Apr-12

35	DIAMOND BANK		28-Aug-09		01-Apr-11	
36	ECOBANK TRANSNATIONAL INC.	07-May-08	08-May-09			
37	EKOCORP	25-Aug-08				
38	FBN HOLDINGS				14-Apr-11	20-Apr-12
39	FCMB GROUP	05-Sep-08		21-May-10	01-Apr-11	
40	FIDELITY BANK	10-Oct-08	24-Nov-09	21-May-10	08-Apr-11	20-Apr-12
41	FIDSON HEALTHCARE	05-Dec-08		15-Jan-10	04-Feb-11	13-Jul-12
42	FLOUR MILLS OF NIGERIA		16-Sep-09	16-Jul-10	07-Jul-11	06-Jul-12
43	FTN COCOA PROCESSORS		03-Apr-09	21-May-10		
44	GLAXOSMITHKLINE CONSUMER NIGERIA	05-May-08	20-Mar-09	26-Mar-10	04-Mar-11	02-Mar-12
45	GOLDLINK INSURANCE			18-Jun-10		
46	GUARANTY ASSURANCE			21-May-10		
47	GUINNESS NIGERIA	22-Aug-08	08-Sep-09	14-Sep-10	16-Sep-11	
48	HONEYWELL FLOUR MILLS			30-Jun-10	08-Jul-11	06-Jul-12
49	IHS				25-Feb-11	
50	IKEJA HOTEL	27-Jun-08		20-Sep-10		
51	INVESTMENT & ALLIED ASSURANCE	08-Aug-08				
52	IPWA	08-Aug-08	04-Aug-09			
53	JAPPAUL OIL & MARITIME SERVICES	16-May-08	17-Apr-09	16-Apr-10		05-Apr-12
54	JULIUS BERGER NIGERIA		05-Jun-09	15-Apr-10	01-Apr-11	
55	LARFARGE CEMENT WAPCO NIGERIA	09-May-08	14-May-09	11-Mar-10	01-Apr-11	07-May-12
56	LASACO ASSURANCE	01-Aug-08	17-Jul-09			
57	LAW UNION & ROCK INSURANCE	26-Sep-08		20-Jul-10	29-Apr-11	
58	MAY & BAKER NIGERIA	05-Sep-08	22-Jun-09			
59	MOBIL NIGERIA		17-Apr-09	06-Apr-10	08-Apr-11	

60	MULTI-TREX INTEGRATED FOODS			16-Dec-10		
61	MULTIVERSE		08-May-09	21-May-10		
62	NATIONAL SALT COMPANY NIGERIA		14-Sep-09	10-Aug-10	27-May-11	20-Apr-12
63	NCR NIGERIA			06-Aug-10	01-Jul-11	20-Apr-12
64	NEM INSURANCE	01-Aug-08	24-Aug-09	06-Sep-10		27-Apr-12
65	NESTLE NIGERIA		27-Feb-09			
66	NIGER INSURANCE	23-Jun-08				29-Jun-12
67	NIGERIAN AVIATION HANDLING COMPANY		09-Apr-09	23-Apr-10	15-Apr-11	
68	NIGERIAN BAG MANUFACTURING COMP.	29-Jul-08	24-Sep-09	15-Jul-10	01-Jul-11	06-Jul-12
69	NIGERIAN BOTTLING COMPANY	16-May-08		23-Apr-10		
70	NIGERIAN BREWERIES		06-Mar-09		25-Feb-11	
71	NIGERIAN-GERMAN CHEMICALS	01-Jul-08				
72	NORTHERN NIGERIA FLOUR MILLS	11-Aug-08	21-Sep-09		01-Jul-11	
73	OANDO	16-May-08	09-Jun-09			
74	OKOMU OIL			09-Apr-10	01-Apr-11	
75	PLATINUM HABIB	07-Nov-08				
76	POLY PRODUCTS			06-Aug-10		
77	PORTLAND PAINTS & PRODUCTS NIGERIA				01-Apr-11	13-Apr-12
78	PRESKO			09-Apr-10	01-Apr-11	
79	PRESTIGE ASSURANCE		25-May-09	18-Jun-10		24-Aug-12
80	PZ CUSSONS NIGERIA	01-Aug-08	04-Aug-09	30-Jul-10		
81	RED STAR EXPRESS		15-Jul-09	01-Jul-10	29-Jul-11	06-Jul-12
82	REGENCY ALLIANCE INSURANCE				17-Jun-11	08-Jun-12
83	RESORT SAVINGS & LOANS			26-Jul-10		
84	ROADS NIGERIA					06-Jul-12
85	ROYAL EXCHANGE					06-Jul-12
86	RT BRISCOE NIGERIA					27-Apr-12
87	SKYE BANK	14-Jan-08	02-Jan-09	05-May-10	11-Apr-11	20-Apr-12
88	SOVEREIGN TRUST INSURANCE		02-Jul-09		29-Jul-11	

89	STANBIC IBTC HOLDINGS		24-Jul-09	13-May-10	18-Apr-11	
90	STANDARD ALLIANCE INSURANCE	08-Jul-08	23-Sep-09			
91	STERLING BANK		30-Jan-09			13-Apr-12
92	TANTALIZERS		03-Apr-09		01-Apr-11	05-Apr-12
93	TOTAL NIGERIA		03-Apr-09	29-Mar-10	14-Apr-11	05-Apr-12
94	TRANS-NATIONWIDE EXPRESS	24-Apr-08	09-Jul-09	28-Jun-10		09-Jul-12
95	TRIPPLE GEE		04-Sep-09			
96	UAC OF NIGERIA		18-May-09		08-Apr-11	
97	UACN PROPERTY DEVELOPMENT COMPANY		17-Apr-09		08-Apr-11	05-Apr-12
98	UNILEVER NIGERIA		09-Apr-09		08-Apr-11	
99	UNIVERSITY PRESS				01-Jul-11	06-Jul-12
100	UTC NIGERIA		09-Jun-09			20-Apr-12
101	VITAFOAM	18-Feb-08	20-Feb-09		06-Jan-11	
102	ZENITH BANK			05-Feb-10	25-Mar-11	

APPENDIX 7.1 - SEMI-STRUCTURED INTERVIEW GUIDE FOR THE DIVIDEND DECISION OF NIGERIAN COMPANIES

SECTION 1: GENERAL INFORMATION ABOUT THE INTERVIEWEE AND THEIR COMPANIES

1. Company Identification Code:
2. Job designation:
3. Sector:
4. Is your company listed on other stock exchanges other than the Nigerian Stock Exchange (i.e. foreign).....
5. Does your company pay cash dividends to shareholders? If yes: Does it pay quarterly, semi-annually, or annually.....
6. Does the Board of Directors set the amount of dividend paid by your company?.....

SECTION 2: FACTORS THAT DRIVE DIVIDEND DECISION

1. Which of the following factors influence your company's dividend decision? How do they influence this decision?
 - a) Current year's earnings.....
 - b) Stability of earnings.....
 - c) Pattern of past dividends.....
 - d) Share price.....
 - e) Current liquidity/ Cash flow.....
 - f) Taxation on dividend.....
 - g) Industry behaviour.....
 - h) Current degree of financial leverage.....
 - i) Any others:
5. Which of the above is the main factor that drives the dividend decision of your company?.....
6. Does your company consider shareholders preferences regarding dividends?

7. Is the dividend based on the last year's dividend plus a percentage increase?
.....

SECTION 3: PAYOUT RATIO

1. Does your company have a target dividend payout ratio?.....

2. Does your company revise this ratio frequently or does the one payout ratio continue for several periods?

3. Does your company gradually increase the actual payout ratio to achieve the target payout over a period of years?

4. What is the variable targeted by your company when setting the amount of dividends to pay?
.....

SECTION 4: MARKET SIGNAL

1. Does your company make its dividend and earnings announcements simultaneously?
.....

2. Do these announcements convey separate information? Which is the dominant signal?.....

3. Does dividend news leak to the market in Nigeria prior to formal announcements from companies? If so, how and when?

4. Does the dividend announcement convey a signal about the future earnings prospects of a company?

5. Does an increase in dividend usually lead to a rise in share prices?
.....

6. Is a dividend cut perceived as "bad news" which in turn leads to a decrease in share prices?.....

7. Any other comments:
.....

SECTION 5: OTHER ISSUES AFFECTING DIVIDEND POLICY

1. Is the dividend decision a residual after investment needs have been determined? Or does your company attach considerable importance to both dividend and investment?
.....

2. Does your company's dividend policy fluctuate with the firm's change in investment and financing needs?

3. Is there any relationship between your company's investment, financing and dividend decisions of your company?.....

4. Does your company design its dividend policy to outperform its competitors in same industry?

.....

5. Do you take taxation into consideration when setting your company's dividend policy?

.....

6. Did the introduction of 10 per cent dividend withholding tax made dividends less attractive to shareholders?

.....

Thank you.

APPENDIX 7.2- LETTER TO INTERVIEWEES



Dharma Kovvuri BA MBA FHEA
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To Whom It May Concern

Re: An Interview on the Dividend Policy in Nigeria

We are writing on behalf of Mr. Friday Kennedy Ozo, a PhD student in the Institute of Global Finance and Development (IGFD) at the Lancashire Business School of the University of Central Lancashire United Kingdom. Mr. Ozo is currently undertaking a research project to investigate the dividend policy and stock market reaction to dividend announcements in Nigeria.

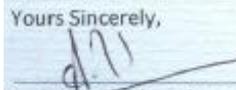
A vital aspect of this study requires Mr. Ozo to conduct interviews with the individuals involved in the determination of dividend policy to examine their views on the factors that drive the dividend decision and the relevance of dividend policy to firm value in Nigeria. Your company has been selected as one of the 21 companies to be interviewed on this subject, and due to your education, practical training and experience in the determination of dividend policy, you have been selected to give us your view on dividend policy in the Nigerian context. Your view is essential to the success of this research.

Please note that the results of this study will be used for the sole purpose of academic research; you and your organisation's identity will be kept strictly confidential as no company details will be divulged. No insider information or other confidential information about your company will be asked during the interviews. Upon the completion of this study, you will receive an executive summary of the findings that will help you understand the market practices in relation to the dividend policy in Nigeria.

The interview has been scheduled to take place between 6th December, 2012 and 6th March, 2013 at head offices of your respective companies in Nigeria. We would therefore appreciate if you can send your contacts and the convenient date and time you are available for the interview to Mr. Ozo on phone to +447423652984 (UK Line), +2348032705687 (Nigeria line) or by email at fkozo@uclan.ac.uk or ozo4real09@yahoo.co.uk . Please note that the Nigerian line will start working as from first week of December.

Thank you in anticipation of your cooperation.

Yours Sincerely,


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Professor of Development Finance & Public Policy,
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University of Central Lancashire, Preston
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APPENDIX 7.3- LIST OF INTERVIEWEES

Interviewee Code	Designation	Date	Time
C1	CFO	20/12/2012	2:30pm-3.20pm
C2	CFO	15/01/2013	9:00am-10:10am
C3	Finance Manager	23/01/2013	12:00pm-1:15pm
C4	Finance Director	17/12/2012	2:20pm-3.30pm
C5	CFO	05/02/2013	12:15pm-1:20pm
C6	CFO	01/03/2013	10:00am-11:00am
C7	CFO	22/02/2013	12:00pm-1:10pm
C8	Finance Manager	12/02/2013	1:00pm-2:05pm
C9	CFO	15/02/2013	12:30pm-1:30pm
C10	CFO	28/01/2013	8:50am-9:50am
C11	CFO	19/02/2013	9:00am-10:10am
C12	Group Finance Controller	21/02/2013	1:40pm-2:45pm
C13	CFO	04/03/2013	12:40pm-1:55pm
C14	CFO	22/01/2013	9:00am-10:12am
C15	CFO	12/12/2012	9:30am-10:35am
C16	CFO	27/02/2013	1:20pm-2:25pm
C17	Finance Manager	18/01/2013	9:00am-10:10am
C18	Finance Director	31/01/2013	11:00am-12:00pm
C19	CFO	25/02/2013	10:30am-11:38am
C20	Finance Director	09/01/2013	2:00pm-3:05pm
C21	Finance Director	08/02/2013	8:20am-9:30am

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