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Evaluating the Effect of Dividend Policy Decisions on Firms' Earnings in Nigeria

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Abstract

This study examines the effect of dividend policy measured by dividend payout ratio and dividend yield on firms' earnings measured by earnings per share in Nigeria. Dividend policy is a critical financial decision influencing firms' performance, yet there remains considerable debate regarding its impact on corporate earnings. This research specifically focuses on 40 listed firms in Nigeria across various sectors from the financial years 2018 to 2021, resulting in 160 firm-year observations. The study employs Panel Estimated Generalized Least Squares with cross-section random effects to analyze the relationship between dividend policy and firm earnings. Findings reveal a weak negative relationship between dividend distributions and firms' earnings, with share prices experiencing a downward trend following negative dividend announcements. Additionally, the study finds that dividend yield has an insignificant effect on firms' earnings, suggesting that share price movements in the Nigerian stock market are not strongly tied to dividend policy decisions. However, a strong positive relationship exists between earnings per share and firms' earnings, as share prices tend to rise following positive dividend announcements. Based on these findings, the study recommends that firms maintain a stable and consistent dividend payout policy to enhance investor confidence and stock market performance. Since dividend announcements influence share price movements, listed companies should strategically manage their dividend policies to maximize shareholder value and sustain high share prices on the Nigerian Exchange Group.

Keywords: *Dividend Policy, Dividend Payout Ratio, Dividend Yield, Earnings Per Share, Firms' Earnings*.

Introduction

The decision regarding how much of a firm's earnings should be distributed as dividends remains a fundamental concern in corporate finance. Dividend policy, which includes decisions on dividend payout ratios and dividend yields, plays a crucial role in shaping firms' financial performance. Companies adopt different dividend policies based on their financial health, economic conditions, and regulatory frameworks. A well-designed dividend policy aims to maximize shareholder returns while ensuring long-term financial sustainability.

There is an ongoing debate regarding the effect of dividend policy on firm earnings and stock market performance. Some scholars argue that dividend payments enhance shareholder wealth by increasing share prices and investor confidence, while others contend that dividend policy has little or no effect on market valuation. The inconsistency in empirical findings highlights the need for further investigation, especially in emerging markets like Nigeria. Dividend payments are typically made from a company’s net earnings after settling obligations to creditors, tax authorities, and preferred shareholders. However, firms must decide whether to distribute earnings as dividends or retain them for reinvestment in growth and expansion. Prior studies suggest that dividend policy is a strategic financial decision that affects both investor confidence and a company’s future performance. If properly managed, it can enhance stock prices, attract investors, and signal financial stability.

Statement of the Problem

Despite extensive research on dividend policy, there is no consensus on its impact on firms' earnings and stock prices, particularly in Nigeria. The theoretical foundations of dividend relevance remain contested. While some scholars assert that dividend policy is irrelevant to market value, other studies suggest that dividend decisions significantly influence share prices. In Nigeria, corporate earnings and stock market performance fluctuate due to varying dividend policies among listed firms. Some companies adopt aggressive dividend payments to attract investors, while others prioritize earnings retention for reinvestment. However, the extent to which dividend payout ratio and dividend yield influence market price per share and earnings per share remains unclear.

One of the major issues in corporate finance literature is determining whether dividend policy implementation affects firms’ earnings and share price movements. The Nigerian stock market has witnessed fluctuations in stock valuations, with some firms experiencing declining market prices despite paying dividends, while others see stock price appreciation even with lower dividend payments. This raises concerns about whether dividend policy significantly influences firm earnings and stock prices or if other factors play a more dominant role.

Hypotheses

This study aims to test the following hypotheses:

i. Dividend pay-out ratio has no significant effect on the firms’ earnings in Nigeria.
ii. There is no significant relationship between dividend yield and the firms’ earnings in Nigeria.
iii. Earnings per share has no significant effect on the firms’ earnings in Nigeria

Literature Review

Theoretical Review

Many different ideas can be used to conveniently explain dividend policy. The two theories at the focus of this investigation are the irrelevance theory and the bird-in-hand theory. These theories serve as the foundation for this research because one of the two main dividend policy schools emphasize the irrelevance of dividends, which is consistent with the irrelevance theory, and the other school emphasizes the relevance of dividends, which is consistent with the bird in hand theory.

Irrelevance Theory

Modigliani and Miller (M-M) introduced the dividend irrelevance theory in 1961. According to this school of thought, a company's dividend policy has no bearing on the price of its shares. The M-M hypothesis, developed by Miller and Modigliani in 1961, offered the clearest defense of this school of thought. According to the M-M hypothesis, in an ideal market with tax-free, cost-free, and trouble-free share sales scenarios, shareholders are agnostic regarding dividends and capital, and a company's worth is defined by the earning potential of its assets as well as investments.

The Bird- In- The- Hand Argument.

Kirshman (1933) presented this reasoning in the following manner: "Of two stocks with identical earning records and forecasts, the one paying a larger dividend than the other would surely command a higher price simply because stockholders prefer current to future values". Due to their certainty, dividends are favoured above capital gains, according to Lintner (1956) and Gordon (1959). They reasoned that rather than leaving the same amount in an investment whose future worth is unclear; investors would prefer to receive a certain dividend payment now.

Empirical Literature Review

Abiahu and Amahalu (2017) examined the effect of taxation on the dividend-paying practices of Nigerian banks from 2006 to 2015. The study employed both the Pearson coefficient of correlation and ordinary least squares (OLS) regression to statistically analyze the relationship between tax obligations and dividend policy decisions. Given that taxation directly influences a company's retained earnings and payout capacity, the study sought to determine whether tax liabilities discourage or encourage dividend distribution among banks. The findings revealed that taxation has a significantly unfavorable effect on dividend policy, indicating that higher tax burdens tend to reduce the likelihood of firms distributing dividends. This suggests that as tax obligations increase, firms are more likely to retain earnings rather than pay them out as dividends. The study further established that taxation affects banks' dividend policies in a statistically significant manner, meaning that variations in tax rates and obligations directly impact how much profit banks allocate to shareholders.

With a focus on five (5) manufacturing enterprises, Akinleye and Ademiloye (2018) x-rayed the effect of dividend policy on the performance of listed manufacturing firms in Nigeria. Panel data was used in the study. The outcome showed that dividend payout has a negligible negative effect on the firm's performance and that dividend per share has a negligible positive impact as evaluated by return on capital employed. As a result, dividend policy has little impact on how Nigerian manufacturing firms determine and/or modify their performance.

A study, by Abdullah, Isiksal, and Rasul (2023) looked at firm's valuation and dividend policy for the financial industry in an emerging nation. From 1995 to 2017, information was gathered from 111 companies in Turkey's financial industry that were listed on Borsa Istanbul. This study uses a variety of multivariate regression techniques in an explanatory research design to look into the suggested links. The findings show that the dividend policy and firm value have a positive and significant relationship.

Adenle (2023) evaluated the impact of intellectual capital on the creation of dividend policies for listed non-financial corporations in Nigeria over seven years (2013-2019). The research design used for the study was descriptive. The sample frame included 36 listed non-financial enterprises, whereas the population included 112 listed non-financial firms. The study concludes that investing in intellectual capital is a tactical move business may make to affect their company's worth, which will ultimately result in bigger dividend payouts. The dividend distribution and accounting information disclosure of listed pharmaceutical corporations in Nigeria from 2016 to 2021 were examined by Odoemelam and Obiora (2023). They explored the relationship between dividend distribution and accounting information disclosure in the pharmaceutical industry. Focusing on listed pharmaceutical firms in Nigeria from 2016 to 2021, the study employed the panel least squares (OLS) approach to analyze the data. The results indicated a significant impact of dividend payouts on earnings per share (EPS), suggesting that firms with a consistent dividend payment strategy tend to experience higher earnings per share. This finding aligns with the signaling theory of dividends, which posits that dividend payments serve as a positive signal of a firm's financial health and profitability. The study further emphasizes the role of transparency in accounting disclosures, as well-managed financial reporting enhances investor confidence and influences dividend distribution policies.

Sidhu et al. (2023) conducted an extensive analysis of the dividend policies of 33 Indian banks from 2010 to 2019, focusing on the impact of financial distress on these policies. The study aimed to determine whether banks experiencing financial difficulties adjusted their dividend distributions to accommodate their financial constraints. Given the critical role of dividend policies in signaling a firm's financial health, the study explored how banks managed their dividend decisions in times of economic strain. The findings indicated that financial distress significantly influenced the dividend policies of Indian banks, with financially constrained banks often reducing or suspending dividend payments to preserve liquidity and stabilize operations.

Additionally, Sidhu *et al.* (2023) examined the role of shareholder activism in shaping the relationship between financial distress and dividend policies. Shareholder activism, which refers to the influence of investors in corporate decision-making, was found to play a moderating role in dividend decisions. The study revealed that under strong shareholder activism, financially distressed banks were more likely to maintain dividend payments despite economic difficulties, as investors exerted pressure on management to prioritize shareholder returns. This suggests that firms operating in environments with active shareholders may experience different dividend policy dynamics compared to those where shareholder influence is minimal.

Furthermore, the study concluded that dividend payments had a considerable effect on shareholder activism. Companies that consistently paid dividends were more likely to attract and retain active investors who closely monitored management decisions. Conversely, firms that reduced or eliminated dividend payments risked facing increased scrutiny and potential conflicts with shareholders.

Gaps in Literature

The multiple empirical and theoretical discussions on Nigerian firms' earnings and dividend policy, as well as those from other emerging economies, highlight the varying perspectives among scholars on this subject. These differences in conclusions stem from variations in the proxies, indicators, and data used to examine the relationship between dividend policy and firms' earnings. Despite extensive research, the existing literature presents conflicting results, with no consensus on whether dividend policy significantly impacts firms' earnings in Nigeria.

Conceptual Framework

To bridge this gap, this study adopts a well-defined conceptual framework that systematically captures the key variables and their measures. The dependent variable, firms' earnings, is measured using market price per share (MPS) and earnings per share (EPS), which are widely accepted indicators of a firm's financial performance and shareholder value. The independent variable, dividend policy, is represented by two key measures: dividend payout ratio (DP), which reflects the proportion of earnings distributed as dividends, and dividend yield (DY), which indicates the return on investment for shareholders based on dividends paid relative to share price.

Research Methodology

This study employs a panel data approach to examine the impact of dividend policy on firms' earnings in Nigeria. The analysis follows a structured econometric framework, beginning with unit root testing to confirm stationarity, followed by cointegration analysis to determine the long-run relationship among variables, and finally, estimation using the Panel Estimated Generalized Least Squares (GLS) technique.

Model Specification

To accomplish the objectives of this study, a model was formulated as a procedure for creating logical reasoning and abstraction of economic reality. The financial econometric variables used for the study's dividend policy served as the foundation for the model's specification.

The research tests the quantitative data using the following econometric model:

$MPS = f\ \{DP, DY, EPS\}$ ………………………………. (1.1)

The econometric form of the above equation is shown below:

$MPS_{it} = \beta_0 + \beta_1 DP_{it} + \beta_2 DY_{it} + \beta_3 EPS_{it} + \mu_{it}$……………... ……. (1.2)

Where:

MPS = Market price per share.

DP = Dividend pay-out ratio.

DY = Dividend yield.

EPS = Earnings per share.

$_{it}$ = represents cross sectional and time units respectively.

$\beta_0, \beta_1, \beta_2, \beta_3$= parameters estimate

β_0= intercept.

$\beta_1, \beta_2, \beta_3$= regression parameters

μ = error term.

Estimation Technique

To ensure robustness, the study follows these key steps:

i. Unit Root Test: A panel unit root test is conducted to verify the stationarity of the variables and prevent spurious regression.

ii. Johansen Cointegration Test: This test is applied to establish the presence of a long-run equilibrium relationship among the variables.

iii. Panel Estimated Generalized Least Squares (GLS): Given the panel nature of the data, GLS estimation is used to handle potential heteroskedasticity and autocorrelation issues, ensuring efficient and unbiased results.

Sources of Data

Data were drawn from the Statistical Bulletin of the Central Bank of Nigeria and banks annual reports were used for the study.

Results and Findings

Table 1

Descriptive Statistics of the Variables

Statistic	Market Price of Share (MPS)	Earnings Per Share (EPS)	Dividend Yield (DY)	Dividend Payout (DP)
Mean	78.43	574.48	4.66	48.56
Median	11.47	99.50	2.98	34.93
Maximum	1555.99	14396.00	88.89	810.00
Minimum	0.44	-637.00	0.00	0.00
Std. Dev.	209.37	1539.97	8.11	75.23
Skewness	5.04	5.78	7.40	6.80
Kurtosis	31.63	45.73	74.51	67.16
Jarque-Bera	6141.80	13059.65	35553.81	28673.31
Probability	0.000	0.000	0.000	0.000
Sum	12548.98	91917.50	746.36	7768.97
Sum Sq. Dev.	6970158.00	3.77E+08	10469.81	899820.00
Observations	160	160	160	160

Table 1 shows the characteristics of the variables. The dividend payout ratio was found to have a mean, median, and standard deviation of 48.55606, 34.93000, and 75.22795, respectively. The value of Jarque-Bera and Kurtosis are also shown in the Table.

Unit Root Tests

Before undertaking the multivariate co-integration analysis, it is crucial to check the stationarity properties of the variables included. The Augmented Dicey Fuller (ADF) unit root test has been run on the levels and differences of the pertinent variables to ascertain the order of integration of these variables.

Table 2

Results of Unit Root Test

Variable	1% Critical Value	5% Critical Value	10% Critical Value	ADF Statistic	Order of Integration
MPS	-3.4717	-2.8796	-2.5765	-13.4782	I(0)
EPS	-3.4717	-2.8796	-2.5765	-13.6952	I(0)
DY	-3.4717	-2.8796	-2.5765	-13.3447	I(0)
DP	-3.4717	-2.8796	-2.5765	-14.0800	I(0)

*ADF = Augmented Dickey-Fuller Test. The null hypothesis assumes the presence of a unit root.

The findings in Table 2 above indicate that all the variables are stationary at levels and have unit roots. As a result, the series is integrated with order zero, I (0), and stationary. I (0) variables, on the other hand, could be brought forward to test for co-integration, following Harris (1995) and Gujarati (2009).

Johansen Co-Integration Test

The Johansen co-integration test was applied to test whether there is a long-term link between the variables.

Table 3

Johansen Co-Integration Test

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.**
None *	0.305406	150.0242	47.85613	0.0000
At most 1 *	0.248663	93.53782	29.79707	0.0000
At most 2 *	0.158312	49.22324	15.49471	0.0000
At most 3 *	0.135171	22.50958	3.841466	0.0000

On the basis of the model's maximum eigenvalue statistics and trace statistics, one co-integrating vector is shown to exist. There is a long-term relationship between the variables since they are co-integrated

Table 4

Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DP	-0.017220	0.066312	-0.259640	0.7955
DY	-0.925570	0.605826	-1.527790	0.1286
EPS	0.024948	0.003929	6.349878	0.0000
C	1.059013	6.595925	0.160556	0.8727
R-squared	0.896671	Mean dependent var		78.43113
Adjusted R-squared	0.894004	S.D. dependent var		209.374

S.E. of regression	68.16581	Akaike info criterion	12.85821
Sum squared resid	720219.6	Durbin-Watson stat	2.661969
F-statistic	336.2657		
Prob(F-statistic)	0.000000		

Table 4 demonstrates that the standard error of the variables for dividend pay-out (DP), dividend yield (DY), and earnings per share (EPS) is less than half of the coefficient's numerical value, indicating reliability in estimation. The significance level for the t-statistics is 5% ($p = 0.00$).

The results indicate that during the study period, EPS ($t = 6.35$, $p < 0.05$) significantly influenced cash dividend distributions. This finding aligns with Frankfurter and Wood's (2003) study, which demonstrated that a firm's dividend policy is highly influenced by its earnings.

Conversely, DP ($t = -0.26$, $p > 0.05$) and DY ($t = -1.53$, $p > 0.05$) exhibited an inverse and insignificant impact on dividend payouts. This finding supports Ranti's (2013) study, which established a negative correlation between the dividend payout ratio and share price for Nigerian-listed companies. Ranti attributes this to restrictive loan agreements that prevent companies from paying cash dividends until they reach a certain earnings threshold.

Additionally, the results are consistent with Okafor et al. (2011), who examined the relationship between dividend yield and stock price volatility in the Nigerian stock market. Using a time-series least squares regression model, they analyzed eight years of data (1998–2005) and found that dividend yield significantly correlated negatively with stock price volatility.

Test of Hypotheses

H0$_1$: Dividend pay-out ratio has no significant effect on the firms' earnings in Nigeria.

This is shown in the equation below:

$MPS_{it} = \beta_0 + \beta_1 DP_{it} + \beta_2 DY_{it} + \beta_3 EPS_{it} + \mu_{it}$

From Table 4.4 above, $\beta_0 = 1.059013$, $\beta_1 = -0.017220$, $\beta_2 = -0.925570$, $\beta_3 = 0.024948$

$MPS_{it} = 1.059013 + \beta_1 -0.017220 DP_{it} + \beta_2 -0.925570 DY_{it} + \beta_3 0.024948 EPS_{it} + \mu_{it}$

The coefficient of dividend policy from model estimation is -0.017220DP. This indicates a negative relationship. However, the t-statistics is -0.259640, probability value of 0.7955. Considering that the p-value is not less than 0.05 level of significance we do not reject the null hypotheses, hence, we conclude that dividend pay-out ratio has no significant effect on the firms' earnings in Nigeria.

H0$_2$: There is no significant relationship between dividend yield and the firms' earnings in Nigeria.

$MPS_{it} = \beta_0 + \beta_1 DP_{it} + \beta_2 DY_{it} + \beta_3 EPS_{it} + \mu_{it}$

Factoring result in Table 4.4:

$\beta_0 = 1.059013$, $\beta_1 = -0.017220$, $\beta_2 = -0.925570$, $\beta_3 = 0.024948$

$MPS_{it} = 1.059013 + \beta_1 -0.017220 DP_{it} + \beta_2 -0.925570 DY_{it} + \beta_3 0.024948 EPS_{it} + \mu_{it}$

The coefficient of dividend policy from model estimation is -0.925570DY. From the regression output, the coefficient of dividend yield (DY) is -0.925570, indicating a negative relationship between dividend yield and firms' earnings.

This suggests that an increase in dividend yield is associated with a decline in firms' earnings. However, the t-statistic is -1.527790, and the corresponding p-value is 0.1286. Since the p-value (0.1286) is greater than the 0.05 significance level, the study fails to reject the null hypothesis (Ho_2). This means that there is no statistically significant relationship between dividend yield and firms' earnings in Nigeria.

The result implies that dividend yield does not have a meaningful impact on firms' earnings over the study period. This aligns with research that suggests dividend yield alone may not be a strong predictor of firm profitability, as other factors such as retained earnings, investment decisions, and market conditions play crucial roles in determining financial performance. However, the findings contrast with studies that argue that a high dividend yield enhances investor confidence, leading to increased share prices and improved firm earnings.

$H0_3$: Earnings per share has no significant effect on the firms' earnings in Nigeria.

$MPS_{it} = \beta_0 + \beta_1 DP_{it} + \beta_2 DY_{it} + \beta_3 EPS_{it} + \mu_{it}$

$\beta_0 = 1.059013$, $\beta_1 = -0.017220$, $\beta_2 = -0.925570$, $\beta_3 = 0.024948$

$MPS_{it} = 1.059013 + \beta_1 -0.017220 DP_{it} + \beta_2 -0.925570 DY_{it} + \beta_3 0.024948 EPS_{it} + \mu_{it}$

From the regression output, the coefficient of earnings per share (EPS) is 0.024948, indicating a positive relationship between EPS and firms' earnings. This suggests that an increase in earnings per share is associated with higher firms' earnings.

The t-statistic is 6.349878, and the corresponding p-value is 0.0000, which is less than the 0.05 significance level. Since the p-value (0.0000) is statistically significant, the study rejects the null hypothesis (Ho_3) and concludes that earnings per share (EPS) has a significant positive effect on firms' earnings in Nigeria.

This result implies that firms with higher earnings per share tend to have better financial performance, as increased profitability attracts investors and enhances market confidence. The findings align with prior studies that have demonstrated a strong link between EPS and firm earnings, reinforcing the notion that EPS is a key determinant of stock performance.

However, this contrasts with studies that suggest that external factors, such as macroeconomic conditions, market sentiment, and regulatory policies, may sometimes weaken the relationship between EPS and firm earnings. Nevertheless, the strong statistical significance observed in this study confirms that EPS remains a critical factor influencing firms' financial performance in Nigeria.

Discussion of Results

The findings suggest that dividend pay-out ratio does not significantly contribute to firms' earnings in Nigeria. The negative relationship observed implies that firms that distribute a higher proportion of their profits as dividends may experience lower retained earnings, which could limit their capacity for reinvestment and growth. This aligns with research indicating that firms with higher retained earnings tend to perform better financially, as seen in the work of Ojogbo, Oke, and Mustapha (2022). However, this contradicts the argument presented by Odum, Omeziri and Egbunike (2019), who found that dividend pay-outs enhance investor confidence, driving share prices and overall firm performance. The conflicting perspectives suggest that the effect of dividend policies may depend on firm-specific factors, investor preferences, or broader economic conditions.

Similarly, dividend yield was found to have an inverse relationship with firms' earnings. While some studies argue that high dividend yields signal financial stability and attract investors, the findings of this study indicate that firms with higher dividend yields may

actually, have lower growth prospects. This contrasts with Abu and Adebayo's (2019) findings, which showed a positive and significant relationship between dividend yield and share prices in Nigeria. The difference in outcomes may stem from variations in market conditions, firm policies, or industry-specific characteristics.

Unlike dividend-related variables, earnings per share emerged as a strong and significant determinant of firm performance. This supports the view that a firm's profitability and financial health are best reflected in its earnings per share, which serves as a key indicator for investors when assessing firm value. The findings are consistent with the work of Ogbaisi, Dabor, and Omokhudu (2022), who also found that earnings per share play a crucial role in determining stock prices and overall firm performance. The positive impact observed further reinforces the argument that firms with strong earnings per share are more likely to attract investors and achieve sustainable growth.

Conclusion

This study aimed at evaluating the effect of dividend policy decisions on firms' earnings in Nigeria, focusing on 40 listed companies from 2018 to 2021. The findings provide valuable insights into the relationship between dividend policy and firm performance, particularly in the Nigerian financial landscape.

The results suggest that dividend pay-out ratio has a negligible and negative impact on firms' earnings. This indicates that increased dividend payments do not necessarily translate to improved firm profitability, as firms that distribute higher dividends may experience constraints on reinvestment and future growth. The findings align with studies that argue that excessive dividend distributions can limit firms' ability to finance expansion and innovation. However, conflicting evidence exists in the literature, with some studies suggesting that dividend payments can enhance investor confidence and drive share price appreciation.

Similarly, dividend yield exhibited an inverse relationship with firms' earnings, further supporting the notion that firms with higher dividend yields may not necessarily achieve stronger financial performance. The results challenge the traditional view that high dividend yields signal financial strength and attract investors. Instead, they suggest that firms focusing on long-term reinvestment may achieve better financial outcomes than those prioritizing high dividend payouts.

On the other hand, earnings per share demonstrated a significant and positive relationship with firms' earnings, reinforcing its role as a key determinant of firm performance. The findings suggest that firms with strong earnings per share tend to experience better financial outcomes, consistent with prior research that links earnings per share to stock price movements and investor confidence.

Based on these findings, the study concludes that dividend policy decisions, particularly dividend pay-out ratio and dividend yield, do not significantly enhance firms' earnings in Nigeria. Instead, earnings per share emerges as the most reliable indicator of firm profitability. Therefore, firms should prioritize strategies that enhance profitability and sustainable growth rather than focusing solely on dividend distribution. While dividends may serve as a signaling mechanism for investors, firms must strike a balance between rewarding shareholders and maintaining sufficient retained earnings for future investments.

As a policy recommendation, firms should consider adopting a flexible dividend policy that aligns with their financial health and long-term strategic objectives. Rather than prioritizing high dividend pay-outs, firms should focus on profitability-driven strategies that enhance earnings per share, ultimately leading to greater shareholder value and market stability.

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