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Extent of Dividend Smoothening in Nigerian Banking Industry

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Abstract

This study examined the extent of dividend smoothening in Nigeria Deposit Money Banks. This is with the intention to investigate the degree at which they pay dividend relative to their earnings. The study used secondary data. The data were gathered from the records of the Nigerian Exchange Group, Central Bank of Nigeria, and banks' financial statements. The population of the study was the entire 14 listed deposit money banks. Ten (10) among the banks were selected with the use of judgmental sampling technique. Data were analysed with the descriptive and inferential statistics. The results showed that all the listed banks observed between 2010 and 2019 smoothened dividend at different degree ranging from high (>1) moderate (<1 but > 0.6) and low (≤ 0.6). The result also revealed that out of the 10 sampled DMBs, 20% has high level of dividend smoothening while 70% moderately smoothening dividend. This implies that they were able to balance between high level and low level of dividend smoothening. The findings further showed that 10% has low degree of dividend smoothening. The study concluded that managers greatly influence dividend policy in the Nigerian banking industry. The study recommended the need for the setting up of a regulatory body that will always look into the dividend payout of banks annually. This is to ascertain that dividends are not smoothened and there should be a regulatory body that will ensure that any payment is done out of distributable profit.

Keywords: Dividend, Dividend smoothening, Deposit money banks, Payout policy
JEL Classification: G30, G39, G21, G35

1.   Introduction

The expectations of shareholders on their investment in any organization include dividends. These have been of great interest to authors since the seminar of Modigliani in 1961 (Javakhadze *et al,* 2014). Accordingly, firms establish a policy on dividend, which is to guide the process of what to pay to the shareholders and the respective frequency. This dividend policy, however, presupposes that firms probably make periodic partial adjustments toward a target pay-out ratio, rather than dramatic changes in their dividends (Javakhadze *et al,* 2014). Dividend policy is, thus, essential for organizations and it is believed to be a widely-investigated issue in the field of corporate finance (Khan et al., 2018). To address any lacuna on dividend policy, organizations, therefore, smooth their dividends. Dividend smoothing is arguably expected to affect the value of firms through the changing of expected earnings in the preceding years (Otieno & Oloo, 2013). Thus, dividend smoothing is seen as a situation when dividends are kept relative to Earnings Per Share (EPS), which involves a moderate dividend declaration.

While banks in Nigeria smooth dividends, little is known of the degree at which this is done. This, therefore, becomes an institutional issue in view of the collapse of some banks that have consistently declared dividend. Despite the extensive debate on dividend pay-out, the actual motivation for paying dividends remains a puzzle (Maude *et al,* 2015). The shareholders of Nigerian banks on many occasions, however, have felt the negative impact of managerial ownership structure of this. This is as a result of near continuous payment of dividend in spite of

what Adeyemi (2011) described as the lack of transparency by the management, leading to their failing the expectations of the regulatory bodies.

It is further argued that this lack of transparency might have led to the collapse of over thirty-six banks, which were declared as unsound and unhealthy and were terminally distressed (Adeyemi, 2011). In view of this, there is a concern by bank depositors, regulators, scholars and other stakeholders that the declared dividend might not have followed an ethical pattern as to the relativeness to earnings. It is, thus, presumed that there could be a possibility of an asymmetric information available to banks' management, which is still not extensively explored by researchers. Consequently, the need to understand the degree of the dividends paid relative to earnings.

While it is believed that stakeholders are majorly of the opinion that bank management in Nigeria, smoothens dividend in order to achieve set out objectives as influenced by ownership structure, the collapse and liquidity problems of some of these banks, foretell a possible smoothening of dividend without recourse to earnings (Bamigboye & Akinadewo, 2020; Anyalechi, 2017). This unexplainable scenario has been a major concern to the industry's regulators, investors, shareholders, scholars and other stakeholders. Scholars have also researched extensively on the determinants of dividend policy, but neglecting the possibility of management owners smoothening the dividend (Bassey *et al*, 2014). In Nigeria, there is copious studies on dividend policy with fewer concentration on the possibility and the degree thereof of dividend smoothening. This is in line with the argument of Kighir *et al* (2018) that there has been fewer research in the area of dividends smoothing in Nigeria. To appropriately and effectively seek solution to this, the study, hence, will determine if dividends are smoothened by banks and the degree at which this is done.

2. Literature Review

2.1 Earnings and dividend smoothening

Dividend smoothing is seen as a situation when dividends are kept relative to Earnings Per Share (EPS). This involves a moderate dividend declaration. Abubakar (2020), however, argued that the principle of dividend payment is based on a long run target payout ratio in place of current earning. Arguing further, Abubakar (2020), cited Lintner (1956), which opined that firms first decide on whether there is a need to change the dividends or not, rather than setting these periodically based on current earnings. To these authors, they decrease dividends when it happens to be the last option and increase dividends when they are confident that the increase could be sustained.

Tekin and Polat (2021), however, believed that policy on dividend becomes essential for firms since information asymmetry problems and agency conflicts constitute market imperfection. This agrees to the assertion of Miller and Modigliani (1961) that irrelevance results do not hold. Accordingly, in a less regulated markets, where firms face more information asymmetry for conveying their earnings quality to investors, they tend to depend more heavily on dividend payments as a signaling device (Tekin and Polat, 2021). This policy, thus, brought about the smoothening of dividend. In the opinion of Javakhadze *et al* (2014), firms with highly concentrated ownership structure and strong corporate governance smooth dividends less. For firms where there is high level of competition, dividends are smoothed more (Javakhadze *et al*, 2014).

Dzidic and Orsag (2019), were of the opinion, however, that dividend smoothing is a global phenomenon. These authors further believed that the likelihood to reduce or cut dividends is greater in civil law countries. Dzidic and Orsag (2019), further asserted that the largest percentage of dividend smoothing firms was recorded in common law countries. Abubakar (2019), however, argued that net earnings and previous dividend significantly affect dividend

changes and smoothing behaviour that exist in firms. Maude *et al* (2015) arguing in respect to the assertion of Abubakar (2019), opined that retained earnings are usually considered in practice, as the most significant source of long-term fund required to finance a firm's long-term growth. The firm, however, must strike a balance in the distribution of these earnings among the conflicting interests like the shareholders, creditors among others (Maude *et al,* 2015). Thus, interest of stakeholders and set-out objectives of the management must be considered by organization in dividend smoothening decisions.

2.2   Determinants of Dividend Payment

These are the elements that influence the decision of management in the declaration and payment of dividend.

Legal Requirement: Legal provision relating to dividend payment is laid in the part XIII of CAMA 2004. This section discusses the framework within which dividend payment is formulated. The law allows the payment only out of distributable profit, which is the profits of a company that is legally available for distribution as dividend.

Profit: Payment of dividend depends on the amount a company made as profit for the year. The level of profit made will determine the dividend to be paid out. It has been empirically gathered that high profit correspond to high dividend payout (DeAngelo *et al,* 2006; Denis & Osobov 2008; Benavides *et al,* 2016).

Liquidity: The decision of a firm to pay dividend is also influenced by the availability of liquid resources. A company that makes profit but does not have sufficient liquid resources may choose not to pay dividend. In the work of Alstadsaeter, Jacob and Michaely (2017), they opined that when there is surplus of cash, it could translate to payment of dividend to shareholders or ploughed back into the business by investing in the capital stock of the firm.

Company Size: A big company can translate to successful and profitable firm. Company size is thus related to profitability, hence, a company making profit has tendency of paying dividend to their shareholders(Consler & Lepak 2016; Denis & Osobov 2008).

Financial Leverage: As the firm continues to expand, the variation in the determination to pay dividend relates to the capital structure of the company(Belo *et al,* 2015). An high geared company tends to have too much debt to redeem, hence, there is likelihood of paying dividend will be low(Von Eije & Megginson 2008). Therefore, low dividend payment or deprivation of dividend is as a result of high debt ratio (Chay & Suh, 2009).

Free Cash Flow: Free cashflow is the amount by which the operating cashflow of a business exceeds the working capital and expenses on fixed asset (Bena & Hanousek 2008) reported that managers always depend on dividend payment to shareholders as signaling tool to communicate the investors that the company is growing. As a result of this, managers at times, when they predict decline in investment opportunities tends to pay dividend out of the free cashflow available (Grullon *et al,* 2002).

2.3   Theoretical Review

The dividend irrelevance theory, dividend relevance theory and signaling theory of corporate finance were but reviewed for this study. The study, however, is underpinned on signaling theory.

2.2.1   Dividend Irrelevance Theory

The main proponents of theory are Modigliani (1958) and Miller (1961). They opined that

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payment of dividend to an investor is irrelevant because investors can always sell a portion of their shares if they need cash. Therefore, two firms at the same industry and scale should have the same value even when one of the firms pays dividends and the other one does not.

Prior to the publication of Miller and Modigliani's (1961, hereafter M&M) seminal paper on dividend policy, a common belief was that the higher the dividend payment, the higher the firm's value. This belief was premised on the so-called "bird-in-the-hand". Graham and Dodd (1934), for instance, argued that "the sole purpose for the existence of the corporation is to pay dividends", and firms that pay higher dividends must sell their shares at higher prices (Frankfurter *et al*, 2002). However, as part of a new wave of finance in the 1960s, M&M demonstrated that under certain assumptions about perfect capital markets, dividend policy would be irrelevant.

They reported that, in a perfect market dividend policy has no effect on either the price of a firm's stock or its cost of capital, shareholders' wealth is not affected by the dividend decision and therefore they would be indifferent between dividends and capital gains. The reason for their indifference is that shareholders' wealth is affected by income generated by the investment decisions a firm makes, not by how it distributes that income. Therefore, in M&M's world, dividends are irrelevant. M&M dividend irrelevance theory opined that, investors calculate the value of companies based on the capitalized value of their future earnings, and this is not affected by whether firms pay dividends or not and how firms set their dividend policies.

2.2.2 Dividend Relevance Theory

This school of thought considers dividends to be active variables, that affect the value of the firm. The view is supported by Lintner (1956), Gordon (1959) and Walter (1963) According to them, the dividend payment policy almost always affects the value of the enterprise, and the investment policy of a firm cannot be separated from its dividend policy. These authors introduced competing theories and hypotheses to provide empirical evidence to prove that when the capital market is imperfect, dividends exert an impact on share value. Consequently, according to the 'bird in the hand' theory of Miller and Modigliani, investors prefer dividends (which are certain) to retained earnings (which are less certain). The intuitive deduction is that firms should set a large dividend payout ratio to maximise firm share value (Brigham and Gordon, 1968; Fisher 1961;Gordon (1959); Lintner, 1956; Walter, 1963).

2.2.3 Signaling Theory

Signaling theory refers to the idea that the agents send information to the principal in order to create credible relationship. Spence (1973) reported that a good firm can distinguish itself from a bad firm by sending a credible signal about its quality to capital markets. Managers have more firsthand information about the firm than firm's investors do, but they are always reluctant to provide transparent information to the shareholders (Hamid, Asma and Shafiullah, 2012). So, the dividend smoothing can be used for information purpose and it also act as a signal for the firm's future projection proficiently. It is said to be an indication of an information sent to the owners of the business by the managers in presenting the organization's financial position in building strong relationships (Ullah. Fida & Khan, 2012).

Signaling theory is also a concept, which posits that the agents send information to the principal in order to create credible relationship. Dividend payout is considered one of the signal transmitters as it contains information about the company's performance (DeForest, 2009). The explanation behind this is that only firms of high quality, high performance and high financial position are those that can continue paying dividends. This is as a result of the high costs associated with distributing dividends such as administration costs. These additional costs may form an obstacle for lower quality firms with poor performance to continue paying dividends or to enable them to maintain high payout levels (DeForest, 2009). Markets, therefore, tend to

assume that as firms have more favourable private information, they choose to pay higher dividends and adjust their share prices (Lease *et al,* 2000). This information about the firm's position makes dividend decisions more valuable to investors as the firm's market value becomes more sensitive to the amount of dividends paid (DeForest, 2009). Miller and Rock (1985) and Li and Zhao (2008) argued that dividend policy plays a leading role because it can be used to convey information to the shareholders about the firm's value. Hence, some firm smoothen dividend in order to retain investors' confidence.

This theory thus, suggests that there is information asymmetry between managers and stockholders. Managers have internal information while stockholders do not. Managers would take costly but credible measures to transfer this information. One of these measures is dividend. Therefore, dividend policy is a signal to transfer the information relating to future profitability (Miller and Rock, 1985; Pettit, 1972). Zeckhauser and Pound (1990) suggested that dividends and institutional shareholders may be viewed as alternative signaling devices. The presence of institutional shareholders may mitigate the use of dividend as a signal of good performance, as these shareholders themselves can act as a (more) credible signal.

Li and Zhao (2008) and Miller and Rock (1985) also supported the idea that dividend policies play a significant role in communicating information to shareholders about the firm's value. According to them, dividends do not just send signals about the health of the company but is also used for investor protection. Consequently, when ownership is diffused and shareholders do not have control over the management of the firm, dividend payouts play a significant role as a monitoring device to avoid any agency problems resulting from the conflict of interests between management and shareholders. For the purpose of this study, signaling theory will be adopted. It is the theory that tends to be most relevant to this study.

2.4   Empirical review

According to literature, it is empirically proven that dividend smoothing is prevalent among firms (Lintner 1956; Fama and Babiak, 1968; Choe, 1990). The root of literatures on dividend smoothing can be traced to the work of Lintner 1956, in which the author reported that organizations always smoothen their dividends relative to their earnings.

After his publication, several researchers have made attempt to explain why firms smoothen dividend. For instance, John and Williams (1985) opined that the optimal dividend policy of firm is to pay smoothened dividend relative to their share price. This was simply referred to as signaling equilibrium. The model adopted in their study shows that, the higher degree of dividend smoothing is as a result of high level of information asymmetry between the management and the investors.

Kuma (1988) also developed a model, which showed that a peculiar level of dividend is related to each distinct range of firms' value. According to the model, if a firm announces a level of dividend payment that deviate from a particular range, the market will regard such as having a value in the lowest range. Guttman, Kadan, Kandel (2010), using the similar approach, argued that there exists partial pooling behaviour in which the payment of dividend is constant for a range of realized earnings. Thus, dividends are smoothened more by a riskier firm (Kuma 1988; Guttman *et al* 2010). These signaling models imply that higher degree of information asymmetry will make most firms incorporate dividend smoothing as part of its policy.

Apart from information asymmetry, Rozycki (1997) reported that tax is also a prominent factor that influences dividend smoothing pattern. This researcher worked on how tax codes affect firms' profitability and dividend payout. The result showed that the personal income tax motivates managers to smoothing dividend payments. The study further showed that the wealth of a tax payer(investors) is increased when dividend is smoothened, by reducing the tax payer's present value of the expected future value of tax liabilities. Leary and Michaely (2011) worked

on 1335 United States firms. The results, which was on dividend smoothing behaviour for a period of 1985- 2005, discovered that dividend smoothing was triggered by agency conflict in the studied firms.

In Nigeria, authors have also researched on dividend policy but with few on the dividend smoothening by the Nigerian deposit money banks. For instance, Agbo (2020), determined the nature and the significance of the nexus between current dividend payout and some explanatory variables like earnings per share. The study, which adopted cross-sectional and time series data was tested with Augmented Dickey Fuller (ADF) procedure. The results showed that earnings per share and inflation are negatively associated with dividend payout policy of commercial banks. The study of Abubakar (2019), however, was on the level of information asymmetry that determines the dividend smoothing behavior of listed firms in Nigeria. The study, which utilised panel data from sample of 20 listed consumer and industrial goods firms in the Nigerian Stock Exchange (NSE) from 2009-2018, argued that dividend smoothing is only present in large firms and not in small firms.

Bamigboye and Akinadewo (2020), researched on ownership structure and dividend policy in Nigerian deposit money banks. The study, which employed secondary data from ten banks believed that concentrated ownership, institutional ownership and management ownership have positive and significant effect dividend policy of DMBs in Nigeria. Maude, Jimoh and Okpanachi (2015) researched on dividend payout pattern from the perspective of Nigeria deposit money banks. The study utilized secondary data from the financial report of the banks. The result showed that the explanatory variables like inflation, share price and earnings per share have significant impact on dividend payout. Abubakar (2020) further researched on asymmetric dividend smoothing in listed industrial goods firms in Nigeria, based on growth potentials. The study which used secondary data of 2006-2016 from the records of nine industrial goods firms from NSE, revealed that these firms smooth dividend payment and have asymmetric dividend smoothing behavior.

From the papers reviewed, many authors concentrated on dividend smoothing from other sectors aside banking industry. Those that researched on banking, however, did not dwell much on the extent to which banks smooth dividends, which was the focus of this study.

3. Methodology

This study focused on only 14 quoted banks in Nigeria, out of which ten (10) banks that paid dividend during the period of study were purposively selected for a period of 10 years ranging from 2010 to 2019. The choice of the base year was the adoption of IFRS in the country which took effect from 1st of January 2012, but with the meeting for the adoption held in 2011. In addition, this period witnessed when the banks were compulsorily requested to disclose the ownership interest of managers with more than 5% ownership stake.

The researcher also adopted Lintner (1956) partial adjustment model for dividend smoothening in order to test the applicability of the model in the context of Nigeria. This study employed multiple regression analysis to measure the extent of company's dividend smoothening decision to analyze the relationship between the dependent and the independent variables; the following regression equation was used:

The Lintner (1956) partial adjustment model of the dividend setting behavior is written as

$$\Delta D_t = \alpha_0 + \alpha_1 E_t + \alpha_2 D_{t-1} + U_t \text{ --- i}$$

Where
ΔD_t is the change of the level of dividend,
E_t is the earnings and

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U_t is the error term.

However, in order to obtain the persistence parameter β_2, the lagged change of dividends is used as the regressor. The higher β_2 is, the more dividend payout depends on its own lag, and thus the more smoothed is the dividend payout, thus β_2 measures the degree of smoothness.

$$\Delta Dt = \beta_0 + \beta_1 E_t + \beta_2 D_{t-1} + U_t \text{-- ii}$$

4. Data analysis and discussion of findings

Table 1: Dependent variable: Dividend Smoothening

Variables	Pooled OLS	Fixed Effect	Random Effect
$h(D_{it}*\text{-}D_{it\text{-}1})$	0.523133	0.516836	0.523133
	(0.0033)	(0.0089)	(0.0089)
X_{it}	0.000138	0.000201	0.000138
	(0.0484)	(0.0510)	(0.0091)
C	1.131582	1.012163	1.131582
	(0.0785)	(0.2299)	(0.0850)
R-squared	0.631888	0.531055	0.563888
Adjusted R-squared	0.601103	0.503907	0.536103
F-statistic	31.10623	9.775650	12.15623
Prob(F-statistic)	0.000068	0.000308	0.000068
Durbin-Watson stat	1.857715	1.853255	1.957715
Hausman test	1.03425		
	(0.3549)		

Source: Authors' Computation (2021)

Table 1 reports the extent of dividend smoothening in Nigerian Banks. The three models of fixed effect, random effect and ordinary least square were estimated. Hausman test was adopted in selecting the most appropriate model to capture the extent of dividend smoothening in Nigerian Banks. The test indicated that fixed effect will not be the most appropriate model and non-normality of the variables will not encourage the use of ordinary least square, therefore, in estimating the parsimonious model of the variables, Random effect method was an appropriate assumption. 56.3 percent of dividend smoothening was accounted for by the explanatory variables, while after adjusting the coefficient of determination due to loss in degree if freedom, the percentage of dividend smoothening fell to 53.6 percent, this implied that about 53.6 percent of the dividend smoothening was accounted for by earnings i.e. independent variables. The f-statistics of 12.156, with the p-value less than 0.05 shows that the explanatory variables are jointly different from zero and Durbin-Watson of 1.9577 reported the likelihood of no serial correlation.

The coefficient (0.0850) showed that there is a positive relationship between the dividends smoothening of Banks and lagged of its change. Current dividend payout of Banks tends to depends on the previous dividend payout and judging by its p-value, the coefficient is statistically significant at five percent level of significance. This is an indication that firms that smooth their earnings more smooth dividends less. Banks with more persistent earnings series smooth less, while those with more cyclical earnings smooth more. Banks adjust dividends quicker when they are below their target than when they are above. However, smoothening is said to be most prevalent among Banks that appear to have the least constrained access to external capital and highest dividend levels.

Table 2 shows how the Y dependent variable was computed for each firm using the formula:

$$\gamma D_{it} = \theta + \rho(D^*_{it} - D_{it-1}) + \varepsilon_{it}$$

Where:

γD_{it}= Change in dividend for the banks i from period t-1 to t. θ= coefficient that will be extracted considering the number of observations in this case 0.1-0.10 based on ten years data sets ρ = Speed of adjustment estimated as beta 0.1-0.10 based on ten years data sets. $(D^*_{it} - D_{it-1})$= Target dividend payout ratio (TP) multiply by earnings in year t minus actual dividend paid or median payout of the banks within the period. ε_{it} = Random error term The dividend payout was the most important aspect in the calculations since firms only gradually adjust dividend payments toward to the target ratio. The table 2 shows results the dividend smoothing computed.

Table 2: Dividend Smoothening

Banks	Θ	$\rho(D^*_{it} - D_{it-1})$	ε_{it}	Dividend Smoothening
ACCESS BANK	0.479188	0.149741	0.029191	0.658119
ECO BANK	0.597356	0.047916	0.069154	0.714426
FIDELITY BANK	0.70071	0.094785	0.101519	0.897015
FIRST BANK	0.54709	0.08889	0.081578	0.717558
GUARANTY TRUST BANK	0.867749	0.461804	0.081093	1.410646
STERLING BANK	0.469001	0.204849	0.081615	0.755464
UNION BANK	0.315352	0.285548	0.099916	0.700816
UNITED BANK OF AFRICA	0.565866	0.088965	0.131769	0.786601
WEMA BANK	0.949658	0.757139	0.053919	1.760716
ZENITH BANKS	0.623903	0.087591	0.118736	0.83023
Average	**0.611587**	**0.2267228**	**0.084849**	**0.923159**

Source: Authors' Computation (2021)

Table 2 reported the level of dividend smoothening in some selected Bank, WEMA Bank had the highest dividend smoothening value of 1.7607. It is an indication that Wema Bank tend to engage in an act which reduces their dividend payout compare to other Banks. GTB also reported high dividend smoothening value of 1.4106, followed by Fidelity Bank with value of 0.8970. Access Bank had the least dividend smoothening of 0.6581, which can be described as a moderate. Diamond Bank, First Bank, Sterling Bank, Union Bank also reported more than 0.5 dividends smoothening in Nigeria. The result supported the findings of Roberts and Michaely (2007), using UK data, where they reported that private firms smooth dividends less than their public counterparts, suggesting that the scrutiny of public capital markets leads firms to pay and smooth dividends. More recently, Leary and Michaely (2009) found that dividend smoothening has been increasing over the past 50 years, suggesting that managers are more concerned about dividend smoothening today. Conclusively, It is obvious that all the selected Banks in Nigeria engage in dividend smoothening, with varying degree.

5. Conclusion and Recommendations

Literature on dividend policy of firms in Nigeria and other parts of the world show that firms smoothen dividend. This is because managers are reluctant to cut dividend, hence they tend to set out a long term target payment of dividends relative to their earnings. The study was carried on smoothening of dividend in the Deposit Money Banks in Nigeria and the specific objectives was on the extent to which dividends are smoothened among the banks in Nigeria.

The result showed that out of the 10 sampled DMBs. 20% has high level of dividend smoothening while 70% moderately smoothening their dividend i.e., they were able to balance between high level and low level of dividend smoothening and lastly 10% has low degree of dividend smoothening

Finally, the study recommends that, there should be a body that will always look into the dividend payout of banks annually in order to ascertain that they are not smoothened and also there should be a regulatory body that will to ensure that dividend is paid out of distributable profit.

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