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AGENCY CONFLICT AND CORPORATE DIVIDEND POLICY DECISIONS IN NIGERIA

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ABSTRACT

Differences in management and shareholders priorities have been recognized and accepted to exist creating problems in the agency to which financial theorists opined that dividend payments is the best means of resolving the conflict. Results obtained using the multiple regression equation model to identify dividend policy determinants of quoted firms in Nigeria showed that solutions to agency problems past dissatisfactory behaviors of shareholders (complaints of shareholders) is not a determinant of current and future dividend decisions while there exists an inverse relationship between the needs and desires of shareholders and the naira dividend paid by the firms. Thus dividend policies of quoted firms in Nigeria are not aimed at solving the existing agency problems in these firms. To resolve the agency problems in quoted firms in Nigeria good corporate governance structure should be enthroned in quoted firms creating better decision structure for dividend; shareholders should be increasingly represented on the board of quoted firms in Nigeria improving on the chance of consideration of their interests in corporate dividend decisions; and the needs of shareholders should be considered in dividend policy design giving them a sense of belonging, increasing satisfaction and reducing agency conflict.

Keywords: Agency theory, Agency conflict, Dividend policy, Investor expectations and shareholders' satisfaction

GEL classification codes: G32, G35, G11, G01, G02

INTRODUCTION

The Linter Partial Adjustment model developed by Lintner (1956) seen to set a new area of study in dividend policy, though failed in determining dividend of a firm in a future period, brought to the fore the need to define a dividend policy for a firm before the period to the awareness of investors; satisfying them and reduce agency conflict. The use of funds of others in a business requires that returns be given on such funds in addition to the repayment of initial funds obtained

for use in the firm. For owners of the firm, dividend may be a necessary reward for providers of funds. The higher these dividends, the satisfied are these owners who see such financial investments as rewarding, and thus attractive to non-owners to invest in. Financial theory supports this idea for such investors to desire holding into such stocks, and others desiring to acquire such stocks. Payment of this reward, dividend, signals good prospects for firms.Finnerty (1986) observed from his study of American firms over a 40 years period that smaller and younger firms do not pay cash dividend to their shareholders. However, he added, at some point in life cycle of any firm it begins paying common dividends. Continuing, he observed that between 80% and 90% of common stocks listed on the New York stock Exchange in any year, pay cash dividends during the year. To Park (2009), dividend payments are associated with firms with good corporate governance, concluding that firms in "legal regimes that focus on protecting investors are more likely to pay" even "higher dividends than firms in legal regimes with less investor protection".

Though investors' predictions of amount of returns they will get affect their investments, Grimblatt and Titman (2003) noted that firms do not vary their dividends to satisfy the demand of different tax clienteles to which Finnerty (1986) advised that firms should establish its dividend policy with a view to maximizing shareholder wealth, set its pay-out policy to keep with its investment opportunities and internal funds need, taking cognizance of the relative preferences of its shareholders for capital gains and dividends; liquidity preferences and the relative costs to the firm and to shareholders of selling shares to meet socio-economic needs when there is no dividend; and legal or policy restrictions on substantial shareholders that may create a preference for dividend income. He observed that dividend change is a signaling device, advising against normal payout of earnings year after year.

To Ahmed and Javid (2009a; 2009b), the dividend policy of a firm should take cognizance of the attitude of the investors towards the dividend. Gordon (1963) concluded that because of the prevalence of inflation and the need to maximize the value of money at each time period, investors prefer current income, cash, to future gains on capital investment. Baker and Wurgler (2004) suggested that managers give incentives, satisfying factors, to their investors according to their needs and wants; catering for them through the smoothing of dividends. These suggest a nexus between dividend payment, amount paid, growth in the amount; and the contentment, satisfaction, investors receive from investment in stock. Dividend policies of firms are determined by internal controllable factors and external uncontrollable factors. The selected policy of a firm must be suitable and achievable by the firm whilst satisfying the investors. Investors' satisfaction enhances the agency theory and reduces conflict between the parties to the agency. The objective of this study is to determine if the resolution of agency conflict in quoted firms in Nigeria is considered in designing corporate dividend policy in Nigeria.

REVIEW OF LITERATURE

Agency Theory and Investors' Expectation

The separation of ownership from management of a firm creates principal/agent relationship between the owners, shareholders; and the management, agent. Differences in management and shareholders priorities according to Frankfurter and Wood (2000) have been recognized and accepted to exist. These differences creates problems in the agency being compounded by unsuccessful attempts by the principal, shareholders; to monitor the agent, management, with huge attendant costs (Kindelberger, 1984)

Modern agency theory seeks to explain corporate structure as the result of attempts to minimize costs associated with the separation of corporate ownership and control. Agency problems are known to result from information asymmetries, potential wealth transfers from debt instrument holders to stockholders through the acceptance of high-risk and high return projects by managers, and their failure to accept potential investment with positive net present values and expenditures in excess of the level expected by perceived prudent managers.

The principal-agent model by Jensen and Meckling (1976) distinguishes between two types of agency costs: the agency cost of equity arising from conflicts of interests between insiders and outside equity holders; and the agency costs of debt arising between equity holders and debt holders. This model has been extensively used in finance literature to understand corporate decisions, including dividend payout ratio (Jensen, 1986; Kim and Sorenson, 1986; Mello and Parsons, 1992; Leland, 1998; Ang *et al.*, 2000). In their findings, La Porta *et al.* (2000) outcome model established a link between minority shareholders' protection, the agency costs of equity and dividend payouts. Under this, dividend is an outcome of effective systems of legal protection of shareholders. By implication, dividend payment is as a result of minority shareholders' pressure on corporate management to reduce cash available in the firm.

In the study of the link between the right of creditors, the agency cost of debts and the observed dividends payouts, Brockman and Unlu (2009) in their substitution model argued that to reduce agency costs of debts, creditors do require and managers agree to pay low dividend to substitute for weaker creditor rights. In the context of minority problems Shao (2010) contended that minority shareholders and creditors have opposite requests for dividend payments. To him, additional payments of dividends can reduce the concern of minority shareholders about expropriation of funds and earnings and reduce the agency costs of equity; while increasing the agency cost of debt and vice versa.

According to Schwartz (1994) submissions, conservative shareholders pay more attention to family security; an attitude reflected in dividend policy. To Shao (2010), shareholders have two ways to

deal with after tax earnings; dividends and retained earnings. Retained earnings can be invested for future risk-returns to shareholders. By contrast, dividends take the form of cash. The demands for more returns, dividends, are based firstly on Keynes money demand theory of transaction, precautionary and speculative motives for holding cash. Thus shareholders holding unto the family value argument will keep more cash for future possible needs and family emergencies, given the same transaction expectations. Secondly, these shareholders may allocate more of the profits earned to high liquidity and low risk assets. This category of shareholders with family securities according to Shao (2010) can be catered for by investing in low risk assets. Combining the two sides of family security needs, the bird-in-hand theory of dividend policy predicts that shareholders prefer stocks which pay consistent high dividend.

In the existence of this agency relationship and problems, both shareholders and managers rely on this agency relationship to meet their respective goals. The relationship provides jobs for managers and helps their career advancement. The shareholders on the other hand need managers to operate their assets. Conservatism emphasizes self discipline, and free cash in the hand of managers is a temptation to squander. Countering this thought, Shao (2010), observed self disciplined managers volunteer to dispense cash in demonstration of their resolve to resist the temptation to squander it adding that conservative shareholders prefer maintaining a healthy relationship between the managers of their firms, adopting measures to avoid problems. Managers spoil this relationship by wasting shareholders' wealth for personal benefits.

Shao *et al.* (2008) observed that in the existence of efforts to reduce conflicts that dividend policies of firms are affected by the culture of the environment where the firms are domiciled and investors live. Their observations not directly linking dividend policy and country culture linked the values of the object of dividend, cash, with a country's culture segregating cultures on conservatism and mastery basis. The more conservative a culture, the higher the dividend payout ratio, and vice versa. Firms in mastery countries (where shareholders keep more cash with the firm), tend to have lowered dividend payout ratios. Thus expectations from shareholders affect dividend policy of firms which itself is determined to avoid conflicts of interest between shareholders and mangers. Detailing, Jensen and Meckling (1976) thought that agency cost arises when firms rely on outside equity ownership. A manifestation of the presence of this cost according to Bajaj *et al.* (2002) is the over-investment of internally generated funds by managers with control (but no ownership); especially if the firm does not have enough positive net present value investment opportunities.

It is well known that since managers are reluctant to reduce dividends, dividends may absorb free cash flow and reduce agency cost (Lintner, 1956). Rozeff (1982) suggested that the payment of dividend by firms with outside equity could reduce agency costs by increasing firms' reliance on external financing, and subject them to increased checking by the capital market. Following Rozeff (1982) and Jensen (1986), it can be said that higher levels of managerial equity holding or more

effective monitoring of management by stockholders will reduce agency cost. Thus the excess returns to a change in dividend, going by this free cash flow/agency cost hypothesis will according to Bajaj *et al.* (2002), be negatively related to the amount of insider ownership and positively related to any attribute of ownership which increases monitoring of a firm's use of free cash flow. To Frankfurter and Wood (2000), dividend policy of a firm affects the agency relationship in two ways. Firstly, as potential shareholders and debt instrument holders' conflict are mitigated by covenant governing claims priority, dividend policy can circumvent this by paying large dividend to shareholders to compensate them in accordance of priority claims on firms' assets to holders of debt instruments. But debt covenant minimize these dividend payments to prevent debt instrument holders' wealth transfer to shareholders. Secondly, dividend policies affect agency cost by reducing it through increased monitoring by the capital market. High dividend payments reduce funds available for consumption and investment opportunities requiring managers to seek extra fund from the capital market. This monitoring by the capital market, according Easterbrook (1984), reduces investments in less rewarding projects, reducing the costs associated with ownership and control. Commenting, Park (2009) observed that payment of dividends might reduce agency costs by reducing the ability of management to waste free cash flow. Jensen (1986) noted that this is necessary because of the probability of managers of firms using retained earnings for investments in projects not beneficial to the shareholders. Defending, Park (2009) said though Jensen (1986) analogy may be true, managers may also be risk averse, preferring to keep much cash against future harsh economic periods; contending that shareholders might be better off if the cash was returned to them for dividend.

With the economic meltdown, investors desire high current dividend to meet their socio-economic needs; confirming an earlier conclusion by Azhagaiah and Sabari (2008) that shareholders preferred current dividend to future income as dividend is an important factor determining shareholders wealth; adding that this is the true in case of salaried workers, retired pensioners, and others with limited income. The high inflation, increasing the cost of socio-economic needs to be satisfied; and the melt-down in the world capital markets has increased the cash expectations of investors from their investment. The bird-in-hand theory of Gordon (1963) supports this reality. Contentment, satisfaction of the investors with their investments, measured by the satisfaction of their needs requires incentives to be given to investors according to their needs and wants. Proposing the catering, theory Baker and Wurgler (2004) suggested the smoothening of dividend payments to meet the investment expectation of investors and enable them satisfy their needs. In conflict, investors by implication will be dissatisfied with the management of their firms as a result of unfulfilled expectations. Paying high dividend comes with attendant costs: cost of increased monitoring of management by shareholders to ensure their funds are safe and their expectations from investments met; and cost of risk aversion on the part of managers to avoid investment in risky projects with huge return and high probability of loss of small investment. To reduce this conflict, Park (2009) suggested that cash available to management be reduced by paying investors

high dividend. With less cash, managers he added will focus on running the firm efficiently, reducing costs. Continuing, he observed that if managers borrow money to finance dividend payment to meet the expectation of investors, the resulting debt provide discipline which Goshen (1995) had earlier explained will require managers to generate more cash flows to meet the interest payments and principal. Park (2009), advised that the payment of a regular dividend to meet shareholders expectations, will keep management focused on maximizing the wealth of shareholders; concluding that evidences abound in finance literature that dividend payments are associated with firms with good corporate governance.

La Porta *et al.* (2000) noted that firms in legal regimes that focus on protecting investors are more likely to pay higher dividend than companies in legal regimes with less investor protection. This finding supports the findings by Kindelberger (1984) that dividend payments are signs that a firm is being run efficiently for investors rather than for management. To minimize the total agency costs, Shao (2010) advised firms to optimize their dividend policy to the point where the marginal savings of agency costs of equity and additional unit of dividend is equal to the marginal increase in the agency costs of debt. With improvements in creditor rights, firms have more discretion to pay dividend as predicted by the substitute model of Brockman and Unlu (2009). The realization of this discretion according the Shao (2010) is predicated on the strength of the minority shareholders' rights to require management to reduce cash available in the firm by paying dividend; noting that firms might choose not to increase dividends.

Dividend Policy, Shareholders' Satisfaction and Reduction in Agency Conflict

Financial theorists describe the relationship between owners and management as a principal-agent relationship with stockholders considered the principals and management as the agents hired by the principals to take actions on their behalf. Evidences abound in finance literature (Rozeff, 1982; Kindelberger, 1984; Frankfurter and Wood, 2000; Bajaj *et al.*, 2002; Grimblatt and Titman, 2003; Kumar, 2009)of the existence of agency problems between shareholders (principal) and management (agents) evidenced by: the push for the sack of firm management, public denunciation of firm management policies and performance, threat of and disposal of shareholding (impacting negatively on the market value of the firm's shares), reduction in management emoluments and unwillingness of Board of directors (selected body of shareholders) to approve proposed investment projects for management. These contended that as long as managers have interests that are distinct from the interest of the shareholders they serve, there is bound to be conflict. In his study of Indian firms, Manos (2002) observed that payments of dividends is one of the measures available to managers for controlling agency behaviors; concluding that by inducing external monitoring, dividends reduce agency problems and costs. To Easterbrook (1984), reduction of agency problem is best achieved by increasing dividend payout (dividend policy).Conclusions from Shao *et al.* (2008) reveal that expectations from shareholders affect dividend policy of firms which itself is determined to avoid conflict of interest between managers and shareholders. A qualitative

analysis of the decision to change dividend according to da Silva *et al.* (2004) can be understood in the argument of Modigliani and Miller (1959) and Miller and Modigliani (1961) information content of dividend. They contended that the adoption of a policy of stabilization by a firm with long established and generally appreciated target payout ratio showed that investors are likely to (and have a good reason to) interpret a change in the dividend rate as a change in management's views of future profit prospects for the firm; concluding that changes in dividend policy may convey information not otherwise known to the market. The signaling effects of dividend payments identified by Bhattacharya (1979) and advanced upon by Miller and Rock (1985) and Johnson and Williams (1985) was empirically tested by Aharony and Swary (1980), Asquith and Mullins (1983) and Healy and Papepu (1988) to be true.

Evidences by Lintner (1956) reveal that management of most firms surveyed preferred a reasonable stable rate of dividend concluding that the market put premium on stability or gradual growth rate of dividend, with strong evidence that these managements desired to avoid making changes in their dividend rates that may need to be reversed within a year (avoiding dissatisfying investors) and reduce agency costs. Fluck (1998) and Myers (2000) similarly provided agency-theoretic models of dividends in order to avoid disciplining action by shareholders. This action according to Jensen (1986) help dissipate cash which would have been wasted in non-value maximizing projects. Satisfaction (contentment) of shareholders with dividend payouts/naira dividend (dividend policy) of their firms evidenced by public commendation of firms' management performance, push for their reappointment, increase in their emoluments, willing approval of managements' investment programs by the Board of Directors (selected shareholders) and the principals' desire to increase their shareholdings reduces conflict with the agents (management). Thus the higher the dividend payouts/naira dividend (dividend policy), the higher the level of contentment (satisfaction) of shareholders; and the lower the degree of agency conflict.

METHODOLOGY

Model Description and Data Analysis

Data obtained from administered questionnaires on 21 (of the 214) quoted firms on the Nigerian stock exchange on dividend policy determinants reveal that twenty factors considered by respondent firms. Factor loadings of these firm-considered determinants were regressed on the naira dividend paid. The relationship between naira dividend payments (Y) and identified determining variables X1, X2, X3, X4, X5, X6, X7, X8, X9, X10, X11, X12, X13, X14, X15, X17, X18, X19, X20 are expected to be linear (Pandey, 2005). Where X1=profitability of the firm, X2= availability of cash, X3= cost of paying dividend, X4= stability of earnings, X5= prospects of raising capital from the capital market, X6= size of the firm, X7= shareholders characteristics, X8= shareholders' needs and requests, X9= availability of investment opportunities, X10= growth prospects of the firm, X13=statutory requirements, X12= restriction by lenders, X11= market value

of the firm, X14 firm policy, X15= rate of inflation, X17= industry declaration rate, X18= industry declaration rate, X19=tax bracket of shareholders, X20= past dissatisfactory behaviors of shareholders. Identified predictors from the regression procedure are X18, X11, X17, X9, X10, X3, X14, X7, X1, X8, X5, X4; while variables excluded were X2, X6, X12, X15; X19 and X20 had missing correlations and were removed from the model because of the nil responses to them by respondent firms, giving a prediction model:

Y= 0.502+ 0.763X1 - 3.949X3 + 14.565X4 – 9.884X5 + 3.125X7- 4.67X8 + 6.72 X9 – 7.86X10 - 3.727X11 + 0.479X14 + 3.2 X17 + 3.54X18

The model with R^2 = 0.939 and a P value of 0.005 (in table 1 in the appendix) show that its prediction of Y is significant.

The ANOVA table (table 2 in the appendix) show that 2.382 of the total variations of 2.536 in Y are as a result of changes in the predictors.

Result can be generalized as study sample, 21, is 10% of the population above the required 5% required for result generalization (Amadi, 2005) (Krejcie and Morgan, 1970).

Table-1. Unstandardized coefficients of constant and predictors of firm dividend policy

Model		Unstandardized Coefficients		T	Sig.
		B	Std. Error		
1	(Constant)	.502	.415	1.210	.265
	X1	.200	.210	.952	.373
	X3	-2.185	.396	-5.512	.001
	X4	3.162	.655	4.825	.002
	X5	-1.921	.285	-6.731	.000
	X7	1.700	.409	4.153	.004
	X8	-3.810	.889	-4.285	.004
	X9	2.458	.631	3.899	.006
	X10	-2.508	.463	-5.416	.001
	X11	-1.098	.212	-5.184	.001
	X13	5.84E-014	.070	.000	1.000
	X14	.069	.023	3.079	.018
	X17	1.335	.158	8.475	.000
	X18	2.095	.474	4.416	.003

a Dependent Variable: y

Research Findings, Policy Implications and Recommendations

Determinants of firm dividend policy (measured by the naira dividend) from regression results are profitability of the firm, cost of paying dividend, stability of earnings, prospects of raising capital from the capital market, shareholder characteristics, availability of investment opportunities, growth prospects of the firm, market value of the firm, shareholders' needs and requests, firm policy, competitors declaration rates and industry declaration rate. Solutions to agency problems

(measured by variables X8 and X20) show that the elimination of X20 (past dissatisfactory behaviors of shareholders) implies the non-consideration of complaints of shareholders in current and future dividend decisions. The negative coefficient of X8 (shareholders' needs and request) of-4.670 implies the existence of inverse relationship between the desire of shareholders and the policy of the firm about the source of the satisfaction of their desire i.e. the higher the needs and more the request of shareholders from expected dividend payments, the lower the amount paid by the firm. Thus existence of agency conflict in quoted firms in Nigeria does not affect firm dividend policy.

Further analysis of naira dividend predictors of firms in Nigeria show that ten predictors (X1, X3, X4, X5, X9, X10, X11, X14, X17, and X18) relate to the firm and two (X7 and X8) relate to shareholders implying that firms give more consideration to the firm in dividend decisions than shareholders.

To resolve agency problems existing in quoted firms in Nigeria:

(i) good corporate governance structures should be enthroned in quoted firms creating better decision structure for dividend, forcing managers/management-shareholders to consider shareholders interest in dividend policy decisions;

(ii) there should be increased representation of shareholders on the board of quoted firms in Nigeria to improve probability of consideration of shareholders' interest in corporate dividend decisions;

(iii) the needs of shareholders should be considered in dividend policy design to give them sense of belonging, increasing satisfaction and reducing agency conflict;

(iv) corporate boards of quoted firms in Nigeria should realize that withdrawal of shareholding by shareholders will affect firm value, and thus should increasingly incorporate shareholder interest in their corporate dividend decisions; and

(v) shareholders of quoted firms in Nigeria should protest to the board of directors at the firm annual general meetings the lopsidedness of dividend-factor determinants favoring the firm and the near nil consideration of their interest in corporate dividend decisions.

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Appendix

Table-2. R and R^2 of prediction model for firm dividend policy

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.969(a)	.939	.826	.14852	.939	8.306	13	7	.005

a Predictors: (Constant), X18, X11, X17, X13, X9, X10, X3, X14, X7, X1, X8, X5, X4

The model (2) with $R^2 = 0.939$ and a P value of 0.005 show that it prediction of Y is significant.

Table-3. ANOVA analysis of dividend policy regression model

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	2.382	13	.183	8.306	.005(a)
	Residual	.154	7	.022		
	Total	2.536	20			

a Predictors: (Constant), X18, X11, X17, X13, X9, X10, X3, X14, X7, X1, X8, X5, X4

b Dependent Variable: y