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CORPORATE GOVERNANCE PRACTICES AND DIVIDEND POLICIES OF QUOTED FIRMS IN NIGERIA

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ABSTRACT

This paper aims to determine the impact of corporate governance of quoted Nigerian firms on the dividend policy of these firms. Sectoral analysis of the dividend payout ratios of 57 quoted firms from13 sectors on the Nigerian stock exchange reveal that Nigerian firms adopt the dividend payout ratios of the industry leader and others the industry average. An impact analysis of corporate governance of these quoted firms on their dividend policies measured by their payout ratios using chi-square shows that corporate governance has no impact on the dividend policies of Nigerian firms as it does in developed economies because in Nigerian firms, shareholder rights are low, firms are controlled by numerical minority director-shareholders who make decisions affecting numerical majority shareholders, agency cost effect of dividend decisions is non-existent as controlling shareholders are also directors, and the rate dividend payout of these firms is an indication of the existence of expropriation of funds by director-shareholders. To redress this situation in Nigerian quoted firms, shares of closely held firms should not be traded on the exchange, maximum shareholding by an individual be the maximum 25%; capital market and firm regulators should verify the accuracy of disclosures to ensure they are not only made to comply with regulations but to instill good corporate governance practices in Nigerian firms.

Keywords: Agency conflicts, Agency theory, Corporate governance, Dividend payouts, Dividend policies, Shareholder rights

JEL Classification: G32, G34, G35.

Contribution/ Originality

This study contributes to existing literature on the impact of corporate governance practices on dividend policies of quoted firms. The Nigerian situation shows that corporate governance has no impact on the dividend policies of Nigerian firms as it does in developed economies. This is

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attributable to the low level of shareholder rights, protecting laws and poor justice redress system, and minority control of listed firms directly or by proxy.

1. INTRODUCTION

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 rewards, 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 play 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. Park (2009) observed that 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".

Determinants identified in financial theory as affecting dividend paying behavior of firms are the availability of cash with which to pay the dividend, amount payable, government regulations, covenant restrictions in business transactions and the availability of viable investment options for dividend-proposed funds. With these, firms strive to continue regular dividend payments to keep themselves attractive to investors; highlighting the proposed amounts when issuing dividend declarations. Firms exhibit a strong aversion to reducing their dividend rates (Frankfurter and Wood, 2000). Reduction in this rate is interpreted by investors as a signal that the firms earning prospects have worsen; though firms in periods of adversity, reduce dividends rate when factors causing such adversities are obvious.

Reductions in dividends rates adversely affect a firm's share price, and in such cases the share prices of firms in the same industry as investors may interpret such reductions as industry affected. Dividend is also often mixed with capital investment decisions. Investors' characteristics determine whether dividend payment is necessary or not. Some prefer current income streams with higher relative tax rates to differed income, capital gains, with lower relative tax rates in the present inflationary situation. Use of margin loans for equity investment purposes, require the generation of current regular income to service and pay such cash loans. The present harsh economic environment, high interest rate, low income, high cost of goods, and delayed salaries make it necessary for investors to receive current regular income to augment earned income and meet socio-economic needs. These needs in Nigeria are basically the physiological needs enumerated by Maslow (1954): shelter, safety, security (financial and physical) and love (family and attendant needs).

The agency theory of dividends posits that dividends mitigate agency costs by distributing free cash flows that firm managers would have spent on unviable investments. The likelihood of firms seeking new funds from outside sources by the distribution of cash through dividend payments has been accepted in finance literature as a cause for scrutiny by the capital market. This scrutiny by the market according to Kowalewski *et al.* (2007) help in alleviating opportunistic managerial behaviours, and cost of agency.

Gompers *et al.* (2003) in their study related agency costs to the strength of shareholder rights; further relating them to corporate governance. The outcome of the two agency models of dividend test by La Porta *et al.* (2000) reveal that dividends are paid because minority shareholders pressurize managers to reduce cash flow in the firms; predicting that firms with weak shareholder rights need to establish a reputation for not exploiting minority shareholders, concluding that such firms pay dividends more than firms with stronger shareholder rights. Commenting, Bebczuk (2005) noted that there is the likelihood of firms with good corporate governance practices paying more dividends, dividend policy.

Four types of ownership disclosures have been identified by the World Bank (2010) to reduce expropriation and promote good governance: information on family ownership, indirect ownership, beneficial ownership and voting agreements between shareholders. Two types of financial disclosures that help investors according to the institution are the audit committee that review and certify financial data and a legal requirement that an external auditor be appointed

These disclosure requirements according to the World Bank (2010) have been met by Nigeria. What is the impact of this level of corporate governance on the dividend policy of Nigerian firms?

1.1. Objective of the Study

The objective of this paper is to determine the impact of corporate governance practices of quoted firms in Nigeria on the dividend policy of these firms.

2. LITERATURE REVIEW

2.1. Corporate Governance and Dividend Policy

The agency theory posit that dividend mitigates agency costs by the distribution of free cash flow that otherwise would have been spent by corporate managers on unprofitable projects. Easterbrook (1984) argued that dividends payments expose firms to more scrutiny by the capital market as the payout of dividend increases the livelihood of such firm issuing new shares to meet their financing needs which on the other hand help alleviate opportunistic management behaviours and thus agency cost. Gompers *et al.* (2003) relate agency costs to the strength of shareholders rights which are associated with corporate governance. Agency theory further suggested that shareholders may prefer dividends particularly when they fear their funds may be expropriated by insider management. Finance literatures Shao *et al.* (2008); Shleifer and Vishney (1986) suggest that minority shareholders are usually at risk in companies controlled by strategic shareholders. With lack of an independent board of directors, many companies in Nigeria and most Europeans countries (Kowalewski *et al.*, 2007) and South Korea (Black *et al.*, 2006) there is the likelihood of firms being vulnerable to potential expropriation.

Black (1990) found no explanation why firms pay cash dividends to their shareholders. Since this work, research at answering this question seemed based on information asymmetries between firms' insiders and outsiders, with suggestions that firms indicate their future profitability by paying dividends. Gomes (1996); Fluck (1998) and Myers and Majluf (1984) recognize that dividend policies address agency problems between corporate insiders and shareholders. Furthering this argument, Grossman and Hart (1980) noted that dividend payouts of firms mitigates agency conflicts by reducing the amount of free cash flow available to managers who in most cases do not act in the best interest of shareholders. Commenting, Jensen (1986) argued that firms with substantial free cash flow may be coerced to accept investment projects with negative cash flows. This takes care of the agency problem by reducing the available cash in the firm through the payment of dividend leaving nothing for investment in zero-net present value projects, which would have generated future agency problems.

The issue of new shares to raise funds earlier identified by Easterbrook (1984) results in increased monitoring by the capital markets and investment banks. Shleifer and Vishney (1986) and Allen *et al.* (2000) noted that institutional investors prefer to own shares of firms that pay regular dividend; arguing that big institutional investors are usually willing and able to monitor corporate managers than smaller owners. As a result, Kowalewski *et al.* (2007) noted that corporate dividend policies can thus be made to meet the needs of institutional investors, whom they think will introduce corporate governance practices. The La Porta *et al.* (2000) outcome model suggest that dividends are paid because minority shareholders put pressure on corporate insiders to reduce available cash in the firm. The substitution model by Brockman and Unlu (2009) predicts that firms with weak shareholders rights need to establish a reputation for not exploiting shareholders. Hence, such firms they advised should pay higher dividends than firm with strong shareholder rights. In other words, dividend paid by them substitute for minority shareholders rights. Bebczuk (2005) observed that because of the above argument there is higher likelihood of firms with good governance practices paying dividends. Ownership of large percentage of shares in a firm according to Barclay and Holderness (1989) reduce the probability of takeover bids, reducing the value of the firm; which is further reduced by the role of a clique of shareholders in selecting managers and board chairmen.

In this instance of control of a firm by a few shareholders, Bukart and Fausto (2001) observed that minority shareholders' interests will not be protected, creating severe agency problem. To solve this, ownership and management of such firm should be separated. The separation may be difficult as owner-managers have the tendency to establish their desire on the firm, control it and discourage dividend payments.

In their study of European business groups, La Porta *et al.* (2000) showed that those with controlling shareholders have strong incentives to siphon resources out of member firms to increase their individual wealth. In their observation of this likely trend, Bertrand *et al.* (2000) noted that there are strong incentives for owners of firms in India to divert resources of their firms. The absence and/or presence of investors protecting laws increases and/or decrease the advent of these practices.

Commenting, Gompers *et al.* (2003) observed that the severity of agency costs is likely inversely related to the strength of shareholder rights. To them firms exposed to agency conflicts are more likely to experience wider divergence of ownership and control especially where shareholders' rights are suppressed. By implication, shareholders' rights are related to agency problem and also to dividend policy. This nexus between corporate governance and dividend policy were established by Gillan *et al.* (2003) and Black *et al.* (2006). The presence and enforcement of civil laws protecting investor negates these negative propositions in capital markets.

Corporate governance is enhanced in Nigeria with the promulgation of the investment securities act 1999, Capital Market Tribunal and ease of obtaining redress in the law courts for corporate abuses. The presence of institutional infrastructures in central Europe according Bonin and Wachtel (2003) aid shareholder rights, dividend payment demand to reduce cash flows, reducing agency problems.

Best practices expected of firms though not responded to according to expectations in Nigeria have brought to the knowledge of managers what is expected of them to promote good corporate governance. To Izedonmi (2010) the proposed adoption of the International Financial Reporting Standards (IFRS) and International Public Sector Accounting Standards (IPSAS) by Nigeria is a drive towards enthroning corporate disclosures and governance operated in major advanced countries in Nigeria. Commenting Azobu (2010) noted that such increases transparency in corporate governance and ease of comparability of firms by investors. Prior to the proposed introduction of IFRS and IPSAS, the companies and Allied matters Act 1999 states the minimum disclosures of firms above the statement of accounting standards (SAS) era when firms refused to comply with its disclosure requirement; now improving corporate governance of Nigerian firms.

As in Europe where Berglof and Pajuste (2003) observed a growing rate of corporate governance in firms, increase in investment and development of acceptable dividend policies, the Central Bank of Nigeria has put in place strategies to remove family ownership of banks, protect minority shareholders, and improve dividends payment and corporate governance.

The control of firms by a clique of shareholders, impedes the independence of the board of directors, creating potential avenues for expropriation and establishing the conditions for dividend policy explained by the outcome model of La Porta *et al.* (2000)

2.2. Theories of Dividend Policy

Theories by researchers on dividend payouts and patterns are based on the perceptions, information carrying content and problem-solving ability of the payouts and patterns. The bird-in-hand theory was developed by Gordon (1963) and Walter (1963) in which they concluded that investors always prefer cash in hand rather than a future promise of capital gain, implying higher current dividend payout and smoothening to investors.

The catering theory by Baker and Wurgler (2004) suggest that managers pay dividend according to the needs and wants of the shareholders, implying the determination of shareholder characteristics; and payout ratio and pattern according to the identified characteristics. Thus firms with more low income-earning shareholders need to have a high payout ratio and smoothened dividend while firms with large number of high income-earning should maintain low dividend payout ratio and less dividend smoothening.

Under the signaling theory by Bhattacharya (1979) and extended by John and Williams (1985) dividend payout and pattern allay information asymmetric between managers and shareholders by delivering inside information of firm future prospects. Jensen and Meckling (1976) developed the agency based on the conflict between managers and shareholders to which dividend payout and pattern acceptable to shareholders should resolve. The life-cycle theory of dividend payout and pattern was developed by Lease *et al.* (2000) and extended by Fama and French (2001) requiring firms to devise a payout ratio and pattern in accordance with their business life cycle. The Miller and Modigliani (1961) dividend irrelevance theory posits that the dividend payout, pattern and their dynamism do not affect firm value. These theories aid decision on dividend payout and patterns for the achievement of optimal results.

3. RESEARCH METHODOLOGY

3.1. Population for the Study

The population for this study is the 194 firms listed on the Nigerian Stock Exchange with dividend paying history.

3.2. Study Samples and Sampling Techniques

57 listed firms with dividend paying history are sampled for the study using the strata sampling technique. Sampled firms occupy the top strata of the dividend paying dividend category.

3.3. Validity and Reliability of Data

Data on firm dividend payout for this study were obtained from analysis of annual firm dividend per share in relation to annual firm earnings in annual reports of sampled firms. These reports are prepared in accordance with the requirements of the Companies and Allied Matters Act, 1999 and the Nigerian Stock Exchange requirements, and were audited by external auditors and are thus valid and reliable.

3.4. Data for this Study

Data for this study is presented in fig 1:

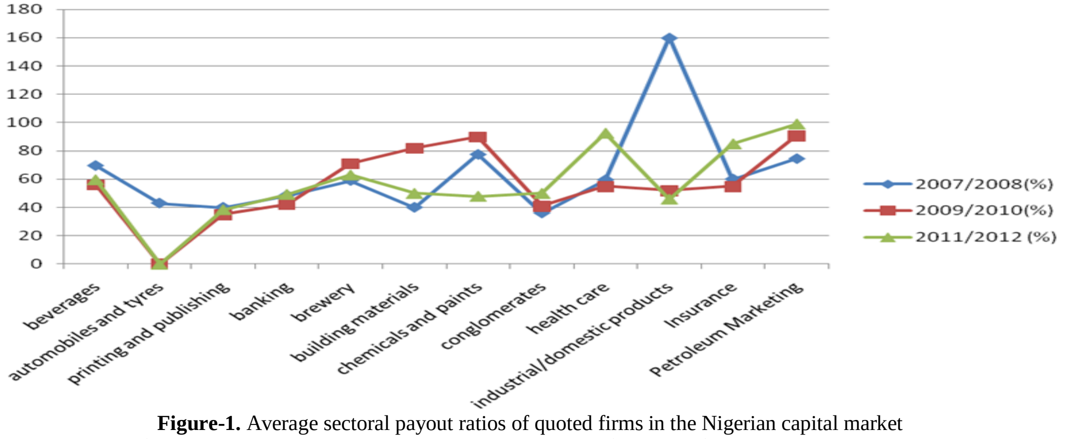

Figure-1. Average sectoral payout ratios of quoted firms in the Nigerian capital market
Source: compiled from the 2007-2009, and 2012 Nigerian stock market annual of individual firms.

Figure 1 shows that during the 2007/2008 years the food and beverages sub-sector dividend payout was 69.67%; dropping to 56% in the 2009/2010 years, increasing marginally to 59.67% in the 2011/2012 years. The automobile and tyres sub-sector paid 43% of earnings as dividend in the 2007/2008 years while the payout ratio for the 2009/2010 and 2011/2012 years were nil. The printing and publishing sub-sectors had a payout ratio of 40% in the 2007/2008 years; falling to 35% in the 2009/2010 years, increasing marginally to 38.5% in the 2011/2012 years. The banking sub-sector's dividend payout was fairly stable: 48.5% in the 2007/2008 years, declining to 42.33% in the 2009/2010 years to increase to 49.33% in the 2011/2012 years. This dynamic pattern was witnessed in all other sectors. The brewery sub-sector's payout for 2007/2008 was 59%, increasing to 71% in 2009/2010 years, falling to 63% in the 2011/2012 years. Similarly, the building materials sub-sector had a dividend payout ratio of 40% in the 2007/2008years, doubling to 82% in the 2009/2010 years, falling by more than 50% in the 2011/2012 years to 34%. The chemicals and paints sub-sector had a payout ratio of 77.5% in 2007/2008, increasing to 90% in the 2009/2010 years to reduce by almost 50% to 48% in 2011/2012. The conglomerates sub-sector maintained an increasing payout from 36% to 41% and further to 50% in the 2007/2008, 2009/2010 and 2011/2012 years. On the contrary, the healthcare sub-sector witnessed a dynamic payout pattern reducing from 59.5% in 2007/2008 to 55% in 2009/2010, increasing in the 2011/2012years to 92.5%. Similar patterns were witnessed in the industrial/domestic products and insurance sub-sectors which dividend payout ratios were 160% and 60% in 2007/2008, 52% and 55% in 2009/2010 and 46% and 85% in the 2011/2012 years respectively. A growing pattern in payout ratio was witnessed in the petroleum marketing sub-sector increasing from 74.5% in 2007/2008 years to 90.8% in the 2009/2010 years and further to 99% in the 2011/2012 years.

3.5. Data Analysis

To capture the characteristics of Nigerian firms, the transparency index is generated to construct the corporate governance index. X^2 was used to determine the impact of corporate governance measured by the World Bank corporate transparency index: on family ownership disclosures, indirect ownership disclosures, beneficial ownership disclosures, shareholder agreement disclosures, internal audit of financials and public availability of ownership details, on dividend policy of Nigerian firms, measured by their relative payout ratios. The hypothesis:

H_o: Corporate governance practices of Nigerian firms do not affect their dividend policy

will be tested on the assured relationship between identified variables using the chi-square technique on 29 (having corporate governance indices) of the 57 sampled firms:

$$\text{Cal } _{X}{}^{2} = \frac{\Sigma\,(O_i - E_i)}{E_i}$$

Where O_i =observed frequency; E_i =expected frequency on the data on table 2.

The test carries (r-1) (c-1) = (3-1) (3-1) =4 degrees of freedom. ά=10%.

Thus t $_{X}{}^{2}{}_{0.10,4}$ =13.277.

Table-1. Corporate governance index and dividend payouts of listed firms in Nigeria

Corporate governance index	Above average dividend payout	Average dividend payout	Below average dividend payout	Total
Good	8 (7.8)	0 (0.66)	11 (10.48)	19
Fair	3 (2.9)	1 (0.24)	3 (3.86)	7
Poor	1 (1.24)	0 (0.10)	2 (1.66)	3
Total	12	1	16	29

Thus Cal $_x{}^2$= 3.5136.

Since cal $_x{}^2$ ≤13.277, the null hypothesis is accepted. Thus corporate governance practices of Nigerian firms do not affect their dividend policy.

4. DISCUSSION AND POLICY IMPLICATIONS OF FINDINGS

From the above graph we see that firms in the banking, automobile and tyres, printing and publishing, petroleum marketing sub-sectors' dividend pay-outs cluster around the industry averages; showing a desire to maintain what is obtainable within the industry. In the food and beverages, brewery, conglomerates, chemical and paints, building materials and healthcare sub-sectors, we observe that firms pattern their pay-out ratios to that of the industry leaders. Changes in pay-out ratios of these firms seem to be in response to changes in the pay-out ratio of the industry leader.

The need for smoothening dividend supported by findings by Lintner (1956) is not reflected in the dividend behaviour of Nigerian firms. Only the food and beverages, printing and publishing and the banking sub-sectors have their dividends smoothened. The conglomerates and petroleum marketing sub-sectors maintained a low dividend with steady growth pattern. The automobile and tyres, brewery, building materials, chemicals and paints, construction, healthcare, industrial/domestic products, and insurance sub-sectors show dynamic dividend behaviours: increasing-decreasing-increasing and decreasing-increasing-decreasing patterns with no explanation by any dividend theory. While a fairly above average pay-out ratio was maintained by the food and beverages sub-sector, the automobile, banking, printing and publishing sub-sectors maintained a below average pay-out ratio during the 2006-2012 years.

Good corporate governance is relevant for poor countries, including Nigeria, seeking equity from business partners. Preventing expropriation and exposing it when it occurs, requires legal protection of shareholders, enforcement capabilities and disclosure of ownership and financial information.

Nigerian investors benefit greatly from this legal protection from redress and regulatory protections. If expropriations are unpunished, few Nigerian investors will invest in quoted firms. These findings imply that quoted firms will not reach an efficient size for lack of financing as few investors will invest in such firms, and economic growth from increased capacity utilization and increased income from dividend flows will be hindered.

Differences among countries in the structure of laws and their enforcement explain the prevailing differences in financial markets worldwide and show that financial development of these markets is promoted by better protection of investors. The severity of agency costs in Nigerian firms is inversely related to the strength of shareholder rights, exposing them to agency conflicts between directors, director-shareholders and numerical majority non-controlling shareholders which from empirical study of Gompers *et al.* (2003) is related to the dividend payout ratios of firms.

Findings from tested hypothesis implies that clique of few numerical minority shareholders control Nigerian quoted firms and make decisions affecting numerical majority shareholders, agency conflict is not alleviated by dividend decisions of Nigerian quoted firms as directors are the clique of minority shareholders controlling the firms, director-shareholders control their firms through proxies inhibiting stronger shareholder rights and enthroning good corporate governance beneficial to shareholders, shareholder rights are low in Nigerian firms, corporate governance of Nigerian firms is anchored on abiding by accounting rules, maintaining high level of social responsibility and making available information required by CAMA 1999 to shareholders, and that good corporate governance in Nigerian firms is measured by disclosures having no impact on decisions affecting shareholders. Indicators of good corporate governance practices of Nigerian firms measured by disclosures do not tell investors/shareholders the accuracy of such disclosures. Disclosures are made to fulfill requirements to which there is no verification of the authenticity of such disclosures by corporate regulators.

5. CONCLUSIONS AND RECOMMENDATIONS

From research results, we conclude that:

(i) Corporate governance of Nigerian firms has no impact on the dividend policies of these firms;

(ii) Agency conflict is not alleviated by dividend decisions of Nigerian quoted firms as directors are the clique of minority shareholders controlling the firms; and

(iii) Dividend payouts of Nigerian firms are below average indicating the existence of expropriation of funds by director-shareholders, using such as a source of income instead of income from dividend, requiring higher dividend payouts.

To improve on the corporate governance of Nigerian firms inter alia their dividend decisions, the following recommendations are made:

(i) Shares of family or closely controlled firms should not be traded in the Nigerian capital market because of their poor corporate governance practices;

(ii) Firms in the Nigerian capital market should be made to adhere to the shareholding rule of maximum shareholding of 25% to majority shareholders to eliminate close holding of firms with resulting poor corporate governance;

(iii) Controlling percentage holding by directors should be divested to reduce their influence on dividend decisions of Nigerian firms;

(iv) Disclosure requirements of the Companies and Allied Matters Act 1999, requiring directors to disclose their financial/business interests in their firms, should be enforced by capital market regulators to ensure shareholder-directors do not expropriate company funds leaving nothing for dividend purposes; worsening the agency problem.

(v) Law requiring firms to pay a statutory percentage of their earnings as dividend should be promulgated so that the dividend rights of non-controlling shareholders are not subsumed. Where dividends are not paid by a firm, such firm should be taxed at a higher rate to discourage building up cash flows for expropriation by directors/director-shareholders to the detriment of minority shareholders;

(vi) "Rubber stamping" of dividend decisions of directors at annual general meetings by shareholders should be meted with stiff sanctions to ensure the dividend decision process is objective;

(vii) Dividend policy of Nigerian firms should be made known to shareholders prior to the dividend period to forestall insider manipulations. Perceived changes to the policy should be explained to shareholders at the annual general meeting; and voting rights of shareholders on dividend issues should be on one shareholder one vote basis to give all shareholder equal decision powers on dividend decisions.

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