DIVIDEND POLICY AND STOCK PRICE VOLATILITY OF QUOTED FIRMS IN NIGERIA (2005-2014)

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BEING A THESIS SUBMITTED TO THE DEPARTMENT OF MANAGEMENT AND ACCOUNTING, FACULTY OF ADMINISTRATION, OBAFEMI AWOLOWO UNIVERSITY, ILE-IFE, NIGERIA IN PARTIAL FULFILMENT OF THE REQUIREMENT FOR THE AWARD OF DEGREE OF MASTER OF SCIENCE IN ACCOUNTING

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CERTIFICATION

This is to certify that IWAMITIGHA Ayodeji Moses carried out this research work under my supervision in the Department of Management and Accounting, Faculty of Administration, Obafemi Awolowo University, Ile-Ife, Nigeria.

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DEDICATION

This thesis is dedicated to God Almighty Who is the Giver of life and Wealth of knowledge.

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Abstract

The study examined the pattern of Share Price changes of Nigerian quoted financial firms from 2005-2014. It also investigated the effect of dividend policy on Share Price volatility, and explored the relationship between retained earnings and Share prices of Nigerian quoted financial firm from 2005-2014. These were with a view of providing information on the effect of dividend policy on share performance of financial firms in Nigeria.

The study employed secondary data. Data were obtained from the audited financial statements of selected quoted companies and the Nigerian Stock Exchange (NSE) Factbooks, from 2005 to 2014. The population for this study comprised all the 21 banks and 34 insurance companies listed on the Nigerian Stock Exchange. A total of 35 quoted financial companies, which include 19 banks and 16 insurance firms which participated in the recapitalisation exercise during the period of the study was purposively selected. Data collected were analysed using graph, percentages and Fixed Effect Method.

The result revealed that share price volatility in the financial sector exhibited a cyclic nature as it oscillated within the band of 0.67% and 22.83% during the study period. In 2005, volatility of financial stocks grew by 22.83%, which implied that stocks of the firms were largely volatile. The result also revealed that dividend yield had negative relationship with stock volatility ($t=-2.3878$, $p<0.05$), while Dividend Payout Ratio exhibited a positive relationship ($t=2.5144$, $p<0.05$). Furthermore, the study found that Retention Ratio ($t=-2.9109$, $p<0.05$) negatively influenced stock price volatility of financial firms.

The study concluded that dividend policy had positive effect on the share prices of quoted financial companies in Nigeria, and can be used as a tool to enhance share performance.

CHAPTER ONE

INTRODUCTION

1.1 Background to the Study

Corporate financial management involves three important decisions to ensure that corporate objectives are achieved namely; financing decision, investment decision, and dividend decision (Baker &Wurgler, 2004).Investment decisions involve the identification of viable projects on which the resources of the firm should be channelled profitably. Financing decision involves the identification of the appropriate sources of finance that would be used to finance the project. Dividend decision involves determination of the amount of dividend payments to compensate fund providers and the amounts of retained earnings to reinvest in new projects.

Shareholders are the providers of equity capital to the firm. They are the owners of the company, thus bearing the largest portion of the risks associated with the company's operation. For this reason, they expect a return called 'dividend' for their investment in the company. Dividend payment is a major component of stock return to shareholders, and dividend payment can provide a signal to the investors that the company is complying with good corporate governance practices. Dividends are usually distributed in the form of cash (cash dividends) or share (share/stock dividends). The challenges in dividend decision are: Whether the company should distribute all or parts of earned profits in the form of dividends to the shareholders; what proportion should be distributed in cash and what proportion to retain in the business? This informs the different dividend policies which are adopted by different firms.

The role of financial manager therefore is to strike a balance between dividend payout and retention of earnings. This is a very difficult task because shareholders have different and conflicting objectives – heterogeneous expectations. Some prefer steady flow of income while others will prefer capital gains arising from increased share prices (Akinsulere, 2010).

Investors constantly seek investment that contains a minimal risk and the highest dividend or return possible. Their perception of the firms and investment decisions they make impact on the demand and supply of shares, which in turn impacts on price. Therefore, one way to measure riskiness of investment is through share price volatility.Adaramola, (2012); Uwuigbe, Olowe and Godswill, (2012); Mgbame &Chijoke-Mgbame, (2011).

Share price's volatilityis a benchmark for measuring risk which indicate changing pace in the stock's price over a determined period; the more considerable volatility implies that the possibility of gain or loss is higher in short term. Share prices with higher volatility results in greater risk that the share might not perform as expected. Also, if the volatility of a share price increases, investors will perceive the share to be more risky and vice versa (Nel & Kruger 2001).

An aspect of dividend policy which has agitated the mind of researchers over decades is in its connection to share prices changes. The connection between the dividend policy of corporations and the volatility of their stock prices has been explored at different times by different researchers. The argument overtime had been whether dividend policy is relevant or irrelevant in determining the prices of stock in the market, yet researchers have not come to congruence of opinion on this subject (Modigliani & Miller, 1961; Gordon, 1963; Baskin 1989; Allen and Rachim, 1996; Nishat and Irfan, 2003).This trend is also discovered to be the same in Nigeria.

Olowe, (2009) noted that stock price volatility has been persistent in the Nigeria Stock

Exchange since the banking reform. In 2004, Central Bank of Nigeria proposed banking reforms increasing the capitalisation of Nigerian banks to N25 billion. In the process of complying with the minimum capital requirement, N406.4 billion was raised by banks from the capital market, out of which N360 billion was verified and accepted by the CBN (Central Bank of Nigeria, 2005). Furthermore, on September 5, 2005, the Federal Government of Nigeria announced the recapitalization of Insurance and Reinsurance companies as N2billion for life insurance companies, N3 billion for non-life operators, N5 billion for composite insurance companies and N10 billion for re-insurers (NAICOM, 2008). In the process of complying with the minimum capital requirement, substantial money was raised by insurance companies from the capital market (Olowe, 2009). This development led to increase in the volume of activities on the Nigerian stock market and brightened the confidence of investors in the Nigerian economy and the stock market, thus, encouraging investment in capital market securities and increasing capital formation. This also affected the volatility of the stock market as prices of stocks, especially of banks began to rise steadily. The boom continued until 2008 when the global economic crisis struck and crashed many stock prices in the market. Investors hope was dashed as many lost a significant proportion of their investments (Uwuigbe, et al, 2012). Most of them still hold on to their devalued investment in the hope that someday, stock prices will rise again.

Should dividend policy be divorced from this scenario?Can dividend policy be used as instrument to bring the fallen shares to their feet? These questions are the motivation behind this study.

1.2 Statement of the Problem

There had been indications in Nigeria in recent time that share performance is falling. This is particularly evident from the irregularities that have pervaded the prices of shares in the Nigerian Stock Exchange overtime. Investors'decisions to invest are informed by a number of factors among which arestability of share prices and dividend decisions of the firm.They want to see if the firm is paying dividend or has the prospect of paying future dividend.