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A Study on the Relationship between Dividend Policy and Corporate Performance – A Case of Listed Companies in the Financial Sector in Zambia

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Abstract

Dividend policy is one of the most complex aspects in finance. The reality is that dividend policy is more commonly an instrument of wealth distribution than it is an instrument of wealth creation. The study of firm performance determinants is a central question for strategic management. This study examines whether dividend policy influences financial firms' performance in Zambia. The choice for the study stems from the important role financial firms play in the financial development of the economy and therefore if not given the critical look could lead to spiralling adverse effects on the other sectors of the economy in which case studies in this area have not received much attention in Zambia. The analysis has been performed using data derived from the financial statements of seven financial firms listed on the Lusaka Securities Exchange (LUSE) during the recent seven-year period 2013 – 2019 on which data were easily accessible. Statistical package for social science (SPSS) was used to estimate the Pearson correlation and analysis of variance (ANOVA) results. The results show negative relationships between firm performance (ROE) and dividend policy. The results further reveal that earnings per share (EPS), dividend per share (DPS) and financial leverage are insignificant in determining the financial firms' performance in Zambia. To the contrary, firm size proved to be a determinant of the financial firms' performance for the present study though it was used as a control variable. Based on the results of the findings, investors should not only depend on dividend policy as espoused by the rational expectations hypothesis when making their investment decisions. Instead, they should analyse the trend in share price movements so that when share prices increase, they can sell their shares and when share prices are low, they can buy new shares. This in turn will increase their capital and value of their investments through capital gains. It is also recommended that firms should strive to utilise all idle resources (assets) if desirable, merge with other firms to reap the benefit of synergy alongside. Specifically, amount of cash being held for precautionary measures may be reduced or reinvested in short term securities. In their propensity to reduce leverage, unprofitable ventures that command huge sums of money may be abandoned. These projects push firms to increase gearing; else firms should associate themselves with risky investments promising higher returns. Thus, firms should not build empires. There is therefore the need for proper feasibility studies before such projects may be carried out.

Key Words: Dividend Policy, Corporate Performance, Earnings Per Share, Dividend Per Share, Financial Leverage, Return on Equity, Dividend.

1.0 Introduction

Dividend policy is the regulations and guidelines that a company uses to decide to make dividend payments to shareholders. Nissim and Ziv (2001). The dividend policy decisions of firms are the primary element of corporate policy and have been an issue of interest in financial literature over the past decades. Dividends are commonly defined as the distribution of earnings (past and present) in real assets among the shareholders of the firm in proportion to their ownership. It represents a distribution of earnings to the shareholders of a company that are usually declared at Annual General Meetings and paid to shareholders. As noted by Ross, Westerfield and Jaffe (2002) companies view the decision as quite important because it determines what funds flow to investors and what funds are retained by the firm for investment. Dividend policy can also provide information to stockholders concerning the company's performance.

Hashemijoo, et al (2012) sees dividend policy as a company's policy which determines the amount of dividend payments and the amounts of retained earnings for reinvesting in new projects. An overview of dividend payout pattern shows that profitable mature firms pay higher dividend than younger rapidly growing ones, for example, the British firms have the highest payouts in the industrialised world. North American companies have higher payouts than the Western European and Japanese companies. This is because the former use capital market for financing while the latter use intermediated financing. In contrast, France with strong socialist traditions and Italy with long state intervention tend to discourage dividend payment, Amadasu (2011). Uwuigbe, et al (2012) also assert that while several prior empirical studies from developed economies have shed light on the relationship between financial performance of companies and dividend payout, the same is not true in developing countries like Nigeria. This is because there are quite a lot of researches on the dividend distribution controversy and its causality effect on financial performance, yet there is no universally accepted condition according to Rahman (2013), Muhammed and Zulkifi (2012); Umuigbe, et al, (2012), Zakaria and Tan (2007).

Management's primary goal is shareholders' wealth maximization which in turn maximizes the value of the company. Different scholars have different views on the relationship between dividend policy and the performance of the firm and Zambia is not immune to this debate. As a result, the impact of a company's dividend policy is still unresolved. This study seeks to fill this gap by studying the relationship between dividend policy and the performance of companies in the financial sector listed in Zambia.

1.1 Objectives and Organisation of the Paper

The objective of this paper is to examine the relationship between dividend policy and performance of listed companies in the financial sector in Zambia. To achieve this objective, the paper seeks to answer three questions;

1. To what extent does dividend per share affect firm performance of financial firms listed in Zambia?
2. How do earnings per share affect performance of financial firms listed in Zambia?
3. What is the relationship between dividend policy and performance of financial firms listed in Zambia?

The first part of the study, provides introductory remarks and a detailed background to the issue of the relationship between dividend policy and the performance of financial firms listed in Zambia. It also describes the research objective which mirrored the research questions.

Part two of the study explains both theoretical and empirical evidence of the study. It gave different opinions from different authors pertaining to the effect of dividend policy to the performance of firms listed in security exchanges of different countries.

The research methodology which is a blue print of this study is provided for in part three of the study. Part four of the study presents the findings of the study from the data that was collected. The findings of the study in this part are presented in a form of tables. The results are then interpreted to give brief description and meaning to the statistics given in the data analysis.

The finding of the study presented in part four, are further discussed in detail in part five. In discussing the findings of the study, reference was made to the literature reviewed, thereby drawing differences and similarities.

Part five of the study gives a summary of the study. Not only that, but also conclusions are drawn based on the findings of the study. In addition, recommendations aimed at helping various stakeholders are presented.

2. Literature Review

The literature review focusses on the findings on the relationship between dividend policy and corporate performance. Different studies have been conducted and they have adopted diverse theories that are relevant in any discourse relating to dividend policy and performance of firms. Dividend policy has been categorized into dividend relevance theories, and dividend irrelevance theories (Walter, 1963, Van Horne, 1971; Pandey, 1979, Olowe, 1978 etc.). These studies developed relevant models to ascertain the relevance or irrelevance of dividend policy as illustrated in the bird – in hand theory and Modigliani and Miller (MM) theories. These theories are often used to explain the relationship between dividend policy, performance and value of firms.

2.1 Dividend Policy Theories

2.1.1 Dividend Irrelevance Theory

Investors are indifferent between dividends and retention – generated capital gains. If they are in need of cash, they can sell shares. If they do not want cash, they can use dividends to buy the shares. Many researchers and economics specialists believe that dividend policy is not important because it is not relevant and does not affect the owners' wealth. Modigliani and Miller support irrelevance theory though it is based on unrealistic assumptions (no taxes or brokerage costs). According to Modigliani and Miller's 1961 theorem, the value of the firm is unaffected by its dividend policy in a world of perfect market conditions. Two major assumptions driving the MM irrelevance theorem were that:

I. A firm's management is purely interested in maximizing share-holder value (there is no agency problems).
II. Corporate insiders and outsiders share the same information about a firm's operations and prospects (the symmetric information assumptions)

Brennan (1971) supported the irrelevancy theory of miller and Modigliani and concluded that any rejection of this theory must be based on the denying of the principle of symmetric market rationality and the assumption of independence of irrelevant information. He suggested that for rejection of later assumption, one of these following conditions must exist: firstly, investors do not behave rationally. Secondly, stock price must be subordinate of past events and expected future prospects.

Hakansson (1982) supported the irrelevance theory of Miller and Modigliani and claimed that dividends, whether informative or not is irrelevant to firm's value when investors have homogeneous belief and time additive utility and market is fully efficient. The results for Dogan and Topal (2014) and Narang (2018) also resonate with the dividend irrelevant theory.

2.1.2 Bird in hand Theory

Bird in hand theory states that a relationship exists between firm value and dividend payout. It states that dividends are less risky than capital gains since they are more certain. Therefore, investors would prefer dividends to capital gains (Amidu, 2007). Because dividends are supposedly less risky than capital gains, firms should set a high dividend payout ratio and offer a high dividend yield to maximize stock price. The essence of the bird-in-the hand theory of dividend policy (John Litner in 1962 and Myron Gordon in 1963) argues that outside shareholders prefer a higher dividend policy. Consequently, investors would value high payout firms more highly. In addition, when making dividend payouts, the firm gets a higher rating from rating agencies as compared to a firm not making any dividend payout. With a better rating, the firm will be able to raise finance more easily from capital markets since credit institutions will be willing to give loans to the firms since the payout of dividends shows that the firm has the ability to meet its obligations. In some cases, the firm will be able to borrow at preferential rates and enjoy better facilities.

The "Bird in Hand" theory by Gordon (1961, 1962) argues that outside shareholders prefer a high dividend policy. They prefer a dividend today to a highly uncertain capital gain from a questionable future investment. A number of studies demonstrate that this model fails if it is posited in a complete and perfect market with investors who behave according to notions of rational behaviours (Modigliani and Miller, 1961; Bhattacharya, 1979). Nevertheless, the original reasoning of Gordon (1961) is still frequently studied.

2.2 Empirical Review

The literature reviewed have shown diverse views regarding the relationship between dividend policy and performance of firms. Different industries were studied in both developing and developed countries. It is also sufficed to mention that various variables representing dividend policy and firm performance were used. Among the variables used as firm performance were: Return on capital employed (ROCE), return on assets (ROA), return on equity ROE), Profit after tax (PAT). Some of the variables used as dividend policy were: Earnings per share (EPS), dividend per share (DPS), price earnings ratio and dividend pay-out ratio. Therefore, the study sought to determine the relationship between dividend policy and Firm performance in the financial services industry in Zambia.

2.2.1 Signalling Theory Perspective

The signalling theory proposes that dividend policy can be used as a device to communicate information about a firm's future prospects to investors. Cash dividend announcements send valuable information, which shareholders do not have, about management's assessment of a firm's future profitability that is by reducing information irregularity. Investors may therefore use this information in assessing a firm's share price. The intuition underlying this argument is based on the information irregularity between managers and outside investors, where managers have private information about the current and future fortunes of the firm that is not available to outsiders. Dividend policy under this model is therefore relevant (Al- Kuwari, 2009).

There was vast literature reviewed. According to the studies which were reviewed the majority of these studies postulated that there was a relationship between dividend policy and firm performance which is in line with the signalling theory. This assertion was supported by researchers such as Uwalomwa, Jimoh and Anijesushola (2012) who concluded that, there is a positive association between dividend policy and performance of firms. The variables used were Return on assets, ownership structure, size of firms and dividend pay-out. Samuel Kwaku Agye, Edward Marfo – Yiadom (2011) also examined the relationship between dividend policy and performance of banks in Ghana. The study revealed that there is a relationship between dividend pay-out and firm performance. The variables used ROA, ROE and dividend pay-out.

Other researchers who concluded that there was a relationship between dividend policy and firm performance were Kajola, Adewumi and Oworu (2015) and Priya and Nimalathasam (2013).
Balagobei (2015) in Sri Lanka investigated the relationship between dividend policy and the shareholders' wealth in the manufacturing sector. Dividend policy was represented EPS, DPS and dividend pay – out ratio. Shareholders' wealth was represented by ROE. The results of the study revealed that DPS and dividend pay – out ratio have a significant positive relationship with ROE. The conclusion of the study was that companies should have good and robust dividend policies because ultimately it will attract investments into the organisation and enhance the shareholders' wealth.
Using a sample of 82 listed companies in Colombo Stock Exchange, Wijekoon and Senevirathna (2019) studied the impact of dividend policy on firm performance of listed companies. They used ROE and ROA as the performance indicators and dividend policy was measured by dividend pay-out ratio and earnings per share. Their finding was that there is significant positive impact from dividend policy on firm performance.

It must be noted that, the studies that had been reviewed were important to the current study as they provided relevant information and variables which formed the basis of this study. On the other hand, these studies concentrated on manufacturing industries and or all the listed companies. However, there was little study on the financial firms. The results of the studies are different from the results of the current study whose conclusion was that there is no relationship between dividend policy and corporate performance of financial companies listed in Zambia.

2.2.2 Dividend irrelevance Theory Perspectives
Investors are indifferent between dividends and relation – generated capital gains. If they want cash, they can sell stock. If they do not want cash, they can use dividends to buy stock. Modigliani – Miller (1961) support irrelevance theory whose assertions are that there is no relationship between dividend policy and firm performance. The current study also agrees to this assertion. The results of this study revealed that dividend policy does not affect the performance of financial companies listed on LUSE.
Dogan and Topal (2014) conducted a study to investigate whether their existed a relationship between dividend policy and financial performance of firms listed at the Istanbul Stock Exchange. The study used data of 172 non – financial companies within a time period of four years from 2008 up to 2011. To achieve the objective of the study, the firms were classified into two categories. The first category was made up of those firms which paid cash dividends regularly and the second composed of those firms which paid cash dividends following irregular trends. The study investigated whether there was significant difference between accounting and market based financial performance between those two groups in relation to dividend policy. Further, an empirical analysis was undertaken using multiple regression and t-test as well as descriptive statistics to determine the outcome. The results of the analysis showed that there was a statistically insignificant relationship between accounting-based performance variables (ROA and ROE) and dividend per share.
Velnampy, Nimalthasan and Kalaiarasi (2014) carried out a study to find out the relationship between dividend policy and firm performance of the listed manufacturing companies in Sri Lanka. A set of listed manufacturing companies was investigated using the data representing the periods of 2008 – 2012. Return on equity and return on assets were used as the determinants of firm performance whereas dividend payout and earnings per share were used as the measures of dividend policy. The results of the study showed that there was insignificant relationship between dividend policy and firm performance.
Narang (2018) investigated the relationship between the financial performance and dividend payout among listed firms in New Delhi Stock Exchange. He used the annual reports for the period 2012 – 2017 as the main source of data collection for the 20 sampled firms. The correlation and regression analysis method were employed as a statistical technique for analysing the data collected. The results of the study provide evidence that the dividend policy measures are not significantly correlated with earnings per share, price earnings ratio and dividend payout as dividend policy, return on equity and return on assets as firm performance measures.
In another study, Sugathadasa (2018) in SriLanka conducted a study of dividend policy on the firms' performance. Dividend pay – out, dividend yield, firm size and asset growth were used as dimensions of dividend policy. ROE was used as dimension of firm performance. The findings revealed that there is a negative insignificant relationship between dividend policy and firm performance.

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This study adopted quantitative data technique using panel data type constructed from the annual reports of the listed financial firms. Listed firms were considered for the analysis focussing on the recent seven-year data that was obtained from their financial annual reports and LUSE.

3. Methodology

Data on dividend policy and firm performance was collected from secondary sources of seven (7) listed financial companies in Zambia. The study used data constructed from the financial statements of companies in the financial sector in Zambia for the period of seven (7) years, from 2013 to 2019. The financial statements were obtained from the individual firm's website, LUSE fact book and where feasible directly from the companies. The data consisted of statement of financial position, income statement, statement of comprehensive income, ratios and other relevant information for all listed companies in the financial sector.

The researcher also used textbooks, journals, magazines and the company bulletins to collect other additional data about the firms.

The study adopted Pearson correlation matrix method and analysis of variance (ANOVA) regression research design in seeking to achieve the research objectives. Pearson correlation was used to determine the relationship between the dependent variable and the independent variable. Analysis of variance (ANOVA) was used to determine the relationship between a dependent variable and several independent variables. SPSS was used in estimating the regression results where return on equity was denoted as the main dependent variable with dividend per share and earnings per share being the independent variable as measured by Hashim et al 2013. Leverage and firm size were used as control variable as measured by Kennedy (2015).

4. Results

Table 1 provides a summary of the descriptive statistics of dependent, independent and control variables.

Table 1: Descriptive summary statistics

Summary statistics

	Mean	Standard Deviation	Minimum	Maximum
Return on Equity (ROE)	.242	1.434	-1.970	9.758
Earnings Per Share (EPS)	-.717	3.336	-13.370	7.680
Dividends Per Share (DPS)	.058	.082	.000	.330
In (Firm Size)	20.860	1.630	17.580	23.200
Financial Leverage	0.505	0.644	0	2.354

ROE records an average value of 24% for financial firms studied listed on LUSE. This means that on average, stockholders receive K0.24 of every K1 invested annually. The table records both minimum and maximum of -1.970 and 9.758 respectively indicating the highest forgone alternative benefit an investor may obtain if he decides to invest the financial firms' industry as compared to other government most risk – free assets such as Treasury bills all things being equal.

On average, investors receive approximately 6% in terms of total dividend for the period. Some firms recorded as high dividend as K0.33 per share annually. Others did not receive any dividend at all. 8% variation means dividend paid by firms did not differ much.

A mean of -.717 was recorded meaning on average they recorded negative earnings per share. The maximum of 7.680 means some firms recorded high profits and able to attract investors. The standard deviation of 3.336 means variation among the values used was high.

The firms on average could be said to be moderately leveraged. This thus notwithstanding, a maximum of 2.354 was recorded. This means that the firm is said to be highly geared making it riskier for safe investments. However, this does not also preclude any potential investor from undertaking investments with such firms thereof having regard to other considerations.

The results record an average firm size of 20.860 and standard deviation of 1.630. the control for size using natural log in this manner helped to even out all disparities that may have existed among the sampled firms.

Table 2: Pearson correlation test results

Table 2: Person Correlation

		Return on Equity (ROE)	Earnings Per Share (EPS)	Dividends Per Share (DPS)	In (Firm Size)	Financial Leverage
Return on Equity (ROE)	Pearson Correlation	1	-.353*	-.047	.028	-.066
	Sig. (2-tailed)		.013	.749	.851	.652
	N	49	49	49	49	49

*. Correlation is significant at the 0.05 level (2-tailed).

Results show a negative correlation of -.353 between ROE and EPS. This means that EPS is insignificant in determining the firm performance.

Results show a negative correlation of -.047 between ROE and DPS. This means that DPS is insignificant in determining the firm performance.

Results show a negative correlation of -.066 between ROE and Financial leverage.

Results show a positive correlation of .028 between ROE and firm size.

Table 3: ANOVA RESULTS

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	12.868	4	3.217	1.650	.179[b]
	Residual	85.807	44	1.950		
	Total	98.675	48			

Results show the F-ratio of 1.650. The value is greater than 1 which is good. The result also shows the P-value or significant value of .179 which is above 0.05.

5. Discussion

The pearson correlation between dividend per share and return on equity is -.047. The result suggests that dividend per share does not affect the performance of the financial firms listed on LUSE. The data support the findings by Ijaiya (2013) whose results in his study revealed that there was an insignificant relationship between dividend per share and performance of firms. Narang (2018), Velnampy, and Nimalthasan, P. (2013) also found that dividend per share has insignificant relationship with the performance of companies in their respective studies. The Pearson correlation test result also gave a Pearson correlation of -.353 between earnings per share and return on equity which was a negative relationship. The study suggests that there is no relationship between the two variables. Consequently, this result corroborates the proportions of Velnampy, Nimalthan and Kalaiarasi (2014) who carried out a study on the relationship between EPS and ROE on the listed manufacturing companies in Sri Lanka. Their study concluded that there is no relationship between EPS and ROE.

The correlation test result between firm size and return on equity was .028 a weak positive correlation. Firm size therefore appears to be a predictor in determining performance of financial firms though it was used as a control variable. Studies by Bhayani (2007), Ibrahim (2012), Barako (2007), Hossain (2008), Dogan (2013) allude to the above fact. Company size therefore has a role in the performance of financial firms. The weak correlation could be as a result of a small sample size that was used. Financial leverage and return on equity have a pearson correlation test result of -.066 which is a negative correlation. Though leverage is not statistically reported as a significant predictor in determining firms' performance, it is reported to have a negative impact on performance. This is in agreement with the results of Abiodum (2008), Kebewar and Ahmed (2013), Dogan (2013).

The results from the ANOVA Table show the F-ratio of 1.650. The value is greater than 1 which is good. The result also shows the P-value or Significance value of .179 which is above 0.05. This means that there is no relationship between Dividend policy and Firm performance.

The results of the study resonate with the Dividend Irrelevance Theory by Modigliani and Miller (1961) whose findings were that there is no relationship between dividend policy and firm performance. Dogan and Topal (2014) also conducted a similar study to the current study and their study concluded that there is no relationship between dividend policy and firm performance. Velnampy, Nimalthasan and Kalaiarasi (2014)' s findings also agree to the results of the current study. Narang (2018) and Sugathadasa (2018) concluded that dividend policy is insignificant in determining the performance of firms in New Delhi Stock Exchange and Sri Lanka respectively.

6. Conclusion and recommendations

The research aims to explore the relationship between dividend policy and firm performance of companies in the financial sector listed on the Lusaka Securities Exchange (LUSE). Out of 24 listed companies in Zambia 7 firms in the financial sector were used for the period 2013 – 2019. The statistical test used include: descriptive statics, Pearson correlation and Analysis of variance (ANOVA). The results of the study provide evidence that dividend policy measured in terms of earnings per share and dividend per share does not affect the performance of the financial firms measured in terms of return on equity.

From the fore-going, it is recommended that; Investors should not only depend on dividend policy when making their investment decisions. Instead, they should analyse the trend in price movements so that when prices increase, they can sell their shares and when share prices are low, they can buy shares. This in turn will increase their capital and value of their investments by what is known as capital gain. Further, financial firms should strive to utilise all their assets and where possible, merge with other firms to reap the benefit of synergy. In their propensity to reduce leverage, unprofitable ventures that command huge sums of money may be abandoned to empire building.

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