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CORPORATE GOVERNANCE MECHANISMS AND DIVIDEND POLICY: EVIDENCE FROM QUOTED DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

Decline in dividend payments and weak corporate governance in Nigerian deposit money banks spur the need for this study. Therefore, the study investigates how corporate governance mechanisms such as executive compensation, debt financing, block ownership and directors' ownership influence the dividend policy of these banks between 2006- 2016. The secondary data used for this study was extracted from the annual reports of the banks and different editions of the NSE fact book. Two-Step System Generalized Method of Moments (GMM) estimator was employed for analyses. Findings revealed that executive compensation, lagged dividend and size significantly affect dividend payment of deposit money banks while other mechanisms like debt financing, block ownership and directors' ownership were insignificant in explaining dividend payment in Nigeria banks. The study concludes that executive compensation affects firm's ability to reward shareholders in form of dividend payment in Nigerian deposit money banks. Thus, this study recommends that regulatory bodies like CBN, NDIC should ensure that the compensation paid to the bank executives is regularised so that the interest of investors will not be undermined. In addition, the compensation of the bank executives should be performance based, this will improve their performance and promote higher dividend payment to investors.

Keywords: Corporate Governance, Dividend Policy, Deposit Money Banks (DMBs)

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1. INTRODUCTION

The importance of dividend policy as a finance decision cannot be overemphasised. Dividend payment decisions are important in pursuing the objective of shareholders' wealth maximization and are therefore beneficial to equity contributors. Besides gaining returns on their investment through dividends, it also serves to reduce agency cost of free cash flow and it is considered an effective way of resolving conflict between managers and investors. Over years, payment of dividend has been regarded as a monitoring mechanism that checks managers from acting in sub-optimal manner to the detriment of the firm. However, Rozeff (1982) suggests that the effectiveness of dividend as a monitoring mechanism is enhanced where there are good corporate governance mechanisms. Conflicts arising from differing interests of stakeholders gave rise to the need for corporate governance mechanism. Extant literature shows that such mechanisms are useful in aligning the interest of shareholders and managers, and serves to protect the interest of all stakeholders.

In line with the preceding, this study is motivated by certain factors. On one hand, dividend payment has recorded decline in Nigerian deposit money banks as "payout ratios for the industry have shrunk to 35% from an average of 60% in 2013 (BusinessNews, 2015). The factors responsible for the decline remain uncertain due to the mixed findings reported in the literature. On the other hand, concerns have been raised on issues which in the literature are regarded as internal components of corporate governance mechanism. Such issues include executive compensation, debt financing, block ownership and directors' ownership. Anecdotal evidence suggests that there is a mismatch between executive compensation in Nigerian Banks and the performance of such banks. Moreso, regulatory authority does not interfere in regulating the compensation which is entirely left to the board of directors. As at year 2011, the minimum compensation of executives per annum is about ₦120m (\$779,929) for managing directors that are part owners and ₦100m (\$649,941) for hired managing directors (BusinessNews, 2011) More recently, CBN revealed that huge packages for directors are still prevalent as a weakness in corporate governance in the financial industry (PunchNews, 2017).

Debt financing is another corporate governance channel for which concern has been raised with respect to deposit money banks in Nigeria. The Bank for International Settlements (2014) documents that a larger percentage of these banks are highly levered as compared to other industry sectors. Undoubtedly, this comes with high debt servicing charges. Lastly, block shareholdings and director shareholdings are also corporate governance issues as considerable evidence exists in the literature that these categories of shareholders may exert influence on important decisions of the firm. This may be detrimental to other stakeholders, particularly, minority investors. Directors' shareholdings in Nigeria deposit money banks are becoming rampant and this led to the resultant need for such shares to be disclosed.

Despite all the issues highlighted above, the financial sector has received very little attention in dividend literature. This stimulates the interest to examine whether the declining dividend payment among deposit banks in Nigeria can be attributed to the corporate governance components specified: executive compensation, debt financing, block ownership and directors' ownership. Considerable empirical evidences exist on the relationship between corporate governance mechanisms and dividend policy. However, the existing studies have excluded

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corporate governance factors identified above (executive compensation, debt financing, block ownership and directors' ownership) and attention has been on board characteristics (such as: board size; CEO duality; board independence; non-executive director; board composition) as mechanisms for corporate governance. Although, scant evidence exists in this regard for developed market studies, result of their findings cannot be applied to Nigeria. This is due to differences in market structure, regulatory requirements on dividend and on the financial sector.

2. LITERATURE REVIEW

2.1 Theoretical Considerations

Jensen and Meckling (1976) advanced the agency theory in explaining how conflicts that exist between managers and investors can be resolved through payment of dividend. The authors contend that dividend payment leads to reduction in the agency cost incurred by investors and also the free cash available to managers to meet private benefits. Thus, dividend payment could be used as an internal tool in reducing agency cost by aligning the interest of investors with those of the managers (Easterbrook, 1984; Jensen & Meckling, 1976; Rozeff, 1982). The theory has been advanced in different ways.

Broadly speaking, the outcome hypothesis of La Porta, Lopez de Silanes, Shleifer and Vishny (2000) suggests that agency problems can be reduced through efficient corporate governance systems. The authors regard dividends as outcome of effective governance due to decrease in managers' expropriation arising from good governance. Specifically, monitoring hypothesis of the agency theory explains that shareholder control is regarded as monitoring device in resolving agency conflicts between managers and shareholders. Block shareholders have the required resources emanating from their large shareholdings which can be used to effectively monitor the activities of the managers. Thus, the block shareholders serve as monitors and are able to exert influence on strategic corporate decisions including dividend decisions. Thus, one line of argument suggests higher payment of dividends with higher number of block shareholders. Conversely, the expropriation hypothesis of agency theory holds that high level of block ownership increases tendency of large shareholders expropriating minority shareholders (Shleifer & Vishny, 1997; Maury & Pajuste, 2002). Thus, lower dividend payment is expected with higher level of block shareholdings who may connive with managers to pay lower dividends.

Jensen and Meckling (1976) emphasise the use of debt as a mechanism for minimising agency conflicts between shareholders and managers. The authors argue that debt financing serves to reduce free cash flow due to increase in firms' fixed interest commitments on loan obtained. Thus, this theory postulate that the increased debt financing leads to lower dividend payment as considerable part of the cash flow is employed for debt financing. The link between executive compensation and dividend was also predicted in the agency theory that agents (managers) are usually driven by self-interest which results in agency problem. Jensen (1986); and Shleifer and Vishny (1997) opined that management and directors of a firm may retain excess cash in order to expropriate them for their personal benefits. However, they can be motivated through financial incentives. The provision of such incentives to the agents is to enable them act in the interest of the shareholders. The incentives are useful in motivating the managers so as to enhance corporate performance which will in turn result in a higher dividend payout. Contrarily, reduced dividend

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payout could be predicted from the relationship between executive compensation and dividend payment. This may happen where the incentives of the managers are excessive and do not improve the performance of the firm. Managerial entrenchment hypothesis (Morck, Shleifer, & Vishny, 1988) which was also drawn from the agency literature states that increase in managerial ownership leads to reduction in agency costs as managers more committed to maximizing the value of the firm. Thus, higher dividend is expected with high managerial ownership.

2.2 Empirical Review

Considerable evidence exists on corporate governance and dividend policy. Few of these studies employed the use of corporate governance index as a sole indicator without breaking it down into components. Some studies (Adjaoud & Ben-Amar, 2010; Byrne & O'Connor, 2012; Kowalewski, Stetsyuk & Talavera, 2007; Mitton, 2004) reported positive relationship between corporate governance and dividend policy. These studies argued in line with the outcome hypothesis that firms pay higher dividends if shareholder rights are better protected. Similar argument was advanced by Bill, Iftekhar, Kose, and Liang (2011) that companies with weak shareholder rights pay dividends less generously than firms with high corporate governance standards. However, they reported negative relationship between corporate governance and dividend policy suggesting existence of weak shareholders' rights. Contrarily, other studies (Tahir, Sohail, Babar & Qayyum, 2015; Nwidobie, 2016) found no evidence to show that corporate governance impact on dividend payment.

Other strands of literature examined impact of specific components of corporate governance on dividend payment. Firstly, some studies reported that increase in the managerial compensation will lead to an increase in dividend payment (White, 1996; Kubo & Saito, 2006). The authors contend that compensation incentives of firms are linked to dividend payments in order to reduce agency conflicts between shareholders and management over dividend decisions. Contrarily, other studies (Bhattacharyya & Elston, 2009; Bhattacharyya, Mawani & Morrill, 2002; Rondi, Bhattacharyya & Elston, 2011) found negative relationship between executive compensation and dividend policy. According to these authors, the negative relationship reported derives from the fact that increase in the managerial compensation will lead to decrease in dividend payment as directors solicit for more retention which is usually expropriated in form of salaries and other compensation in order to satisfy their personal benefits at the expense of the shareholders. From another perspective, higher compensation leads to lower dividend payments because higher executive compensation is associated with high quality managers with access to positive net present valued projects. This is consistent with the idea that more productive managers will reinvest more earnings in the production process (Rondi, Bhattacharyya & Elston, 2011). Some other studies found that managerial compensation has no relationship with dividend payout (Bhattacharyya, Mawani & Morrill, 2008; Odia & Ogiedu, 2013).

With respect to debt financing and dividend payout, positive relationship is reported by few studies (Brockman & Unlu, 2009; O'Connor, 2013) based on the notion that creditors exert a significant influence on corporate dividend policy, over and above the influence exerted by shareholders. These studies argue that creditors demand and managers consent as a substitute for weak creditor rights. On the other hand, Chae, et al. (2009) found a negative relationship and debated that the more firms depend on external financing for future investment projects which

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comes with constraints, the less the dividends payout. From a different perspective, debt financing comes with interest charges which reduce the profitability level of a firm and in turn leads to reduction in dividend payout. Other evidence showed insignificant relationship between debt financing and dividend policy (Ambuku, 2014).

Conflicting arguments also exists on how block shareholdings affect dividend payment. One line of argument shows block shareholders can use their large shareholdings to exert influence on dividend decision of the firm. Thus, positive relationship exist between block ownership and dividend policy (Berzins, Bohren & Stacescu, 2015; Masoyi, Abubakar & Adamu, 2016; Mossadak, Fontaine & Khemakhem, 2016; Sakinc & Gungor, 2015; Shehu, 2015; Thanatawee, 2014). Similarly, La Porta, Lopez - de- Silanes, Shleifer and Vishny (2000) opined that firms in developed capital market make high dividend payment irrespective of available investment opportunities because they find it easy to raise external funds from the capital market compared to firms in undeveloped capital market who prefer to hold on to cash than pay dividend. In contrast, the closer alignment of interests between managers and large investors could also justify a negative effect on dividend payout. Thus, some other studies [Aydin & Cavdar, 2015; Idris et al., 2016; Kabiru et al., 2015; Rigi & Ebadi, 2014] found that increase in the shareholdings of large shareholders will lead to decrease in dividend payment. These studies support collusion between controlling shareholders and managers in generating private benefits that are not shared with minority shareholders which lead to a lower dividend payment. However, Mukhtar (2015), Tahir, Sohail, Babar and Qayyum (2015) discovered insignificant relationship between block ownership and dividend pay-out and supported his findings with Miller and Modigliani's (1961) argument that the value of a firm is determined solely by the earnings power of its assets and investments; hence, capital gains and dividends substitute each other.

With respect to director's ownership and dividend policy, prior studies (Shah, Ullah & Hasnain 2011; Shehu, Kamardin & Shehu, 2015) found positive relationship between directors' ownership and dividend policy. The authors asserted that high dividend is usually influenced by managerial shareholders who use their power to influence dividend payment so as to boost the confidence of outside shareholders on the managers and in the end reduce agency conflicts. Contrarily, other studies (Dandago, Farouk & Muhibudeen, 2015; Odeleye, 2015; Ullah, Fida & Khan, 2012) found negative relationship in this regard and these studies contend that increase in the managerial share ownership will increase managers' access to free cash flow which can be expropriated or utilized on projects that are not economical. However, other studies (Mukhtar, 2015; Odia & Ogiedu, 2013; Masoyi et al., 2016) found insignificant relationship between managerial ownership and dividend payment. Over the years, it has been empirically discovered that some variables determine the payment of dividend in firms, such variables include: size, growth opportunities, earnings, cash flow and past dividend (Lintner, 1956; Odia & Ogiedu, 2013; Thanatawee, 2014; Arshad, Akram, Amjad & Usman, 2013; Hasson, Tran & Quack, 2016). Hence this study seeks to add the variable to the regression model to avoid omission of important variables in the model.

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3. METHODOLOGY

This study is based on an unbalanced panel data set of 139 firm-year observations after deletion of observations with missing values and outliers. This was obtained from the 15 listed deposit money banks in Nigeria over the period 2006 to 2016. Data was extracted from the annual reports and accounts of the banks, and different editions of the NSE fact book obtained from the Nigerian Stock Exchange. The analysis is restricted to cash dividends which remain the prominent means of giving back to shareholders in the Nigerian market. To achieve the objective of this study, the following regression model was estimated:

$$D_{it} = \alpha + \beta_1 EXCOMP_{it} + \beta_2 DEBT_{it} + \beta_3 BLK_{it} + \beta_4 DIRS_{it} + \beta_5 P_{it} + \beta_6 D_{it-1} + \beta_7 CF_{it} + \beta_8 SIZ_{it} + \beta_9 GWTH_{it} + \mu_{it} \quad (1)$$

Dynamic panel model was adopted because the dependent variable depends on its own past results. Two-Step System Generalized Method of Moments (GMM) was adopted as the estimation techniques for this analysis. We consider this method appropriate as it uses more instruments and do not impose any restriction on the distribution of the data characterised by heavy tailed and skewed distribution. It is also suitable for panels with fewer times series observations per individual relative to the sample in the cross-section dimension ($N > T$). Moreover, it accommodates unbalanced panels and multiple endogenous variables and also robust to heteroskedasticity and distributional assumptions.

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4. FINDINGS AND DISCUSSION

Table 1 presents the variable definition and descriptive statistics of the explanatory variables.

Table 1: Variable Definition and Descriptive Statistics

Variables	Definition	Obs	Mean	Min	Max
Dividend (D)	Total Equity Dividend Paid Scaled by Total Assets	139	87.234	0	627.93
Executive Compensation (EXCOMP)	Total executives' salary	139	5.0113	0.0872	52.62
Debt Financing (DEB)	Total debt/ Total Assets	139	85.04	11.946	131.86
Block Shareholdings (BLK)	Percentage of shares held by investors with 5% and above	139	28.17	0	100
Director's Shareholdings (DIRS)	Percentage of shares held by directors/ Total Shares Total Board of Directors Shares	139	10.64	0	71.59
Earnings (P)	Net Earnings scaled by total assets	139	206.56	-710.52	1268.37
Cashflow (CF)	Closing cash flow for the year scaled by total assets	139	2246.60	170.96	11088.28
SIZE (SIZ)	Natural logarithm of total assets	139	8.89	8.028	9.63
Growth Opportunities (GWTH)	Total asset ¹ – Total assets ⁰ / Total asset ⁰	139	41.58	-37.94	472.14

Source: Authors' Computation, 2017.

Table 1 shows that the banks made an average dividend payment of ₦8.724billion during the period. However, there is indication that some banks failed to pay dividend in some years because of there is minimum value of zero for dividend payment. The maximum value for dividend payments indicates that the highest payout during the period ₦62.793billion. Preliminary tests (multicollinearity & residual diagnostic) were conducted. Table 2 shows that all the variables have a VIF value less than 10, thus indicating that there is no strong evidence of collinearity among the independent variables (regressors).

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Table 2: Multicollinearity Test Result

Variable	VIF
EXCOMP	1.32
DEBT	1.03
BLK	1.17
DIRS	1.13
P	1.73
CF	1.88
SIZE	2.81
GWTH	1.30
Mean VIF = 1.55	

Source: Author's Computation (2017)

Table 3: Residual Diagnostic Tests

Test	Error Process	Null Hypothesis	Test statistic
Breusch-Pagan/Cook-Weisberg test	Heteroskedasticity	Constant variance	91.14(0.0000)*
Wooldridge test	Serial correlation	No first-order autocorrelation	43.517(0.0000)*

Note: * denotes rejection of null hypothesis at 1% significance level

Source: Author's Computation (2017)

Table 3 shows that there is evidence of heteroskedasticity and serial correlation in the regression model, thus suggesting that the use of the dynamic panel GMM estimation method is appropriate for this study because it overcomes these problems. Table 4 presents the results of the model estimation estimated with the two-step System GMM estimation method.

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Table 4: Two-Step System GMM Estimation Results

Variable	Coefficient
Constant	-416.569(243.342)***
DIV _{t-1}	0.789(0.087)*
EXCOMP	-2.678(0.517)*
DEBT	-1.444(1.485)
BLK	-0.245(0.177)
DIRS	-0.390(0.377)
P	0.040(0.050)
CF	-0.0003(0.006)
SIZE	65.218(36.560)***
GWTH	0.065(0.201)
Model Diagnostics	
AR(1)	-1.86[0.063]***
AR(2)	1.51[0.132]
Wald χ^2	1228.24[0.0000]*
Hansen test	2.32[0.132]
No. of Instruments	12
No. of Groups	15

Notes: * and *** indicate statistically significant at 1% and 10% significance level respectively. Standard errors and p-values are reported in () and [] respectively.

Source: Author's Computation (2017)

Table 4 shows that Executive compensation (EXCOMP) is significantly and negatively related to dividend. This result is consistent with the findings of Bhattacharyya and Elston (2009), Rondi, Bhattacharyya and Elston (2011) but contradicts that of Kubo and Saito (2006), Odia and Ogiedu (2013). This signifies that directors solicit for more retention which is usually expropriated in form of salaries and other compensation in order to satisfy their personal benefits at the expense of the shareholders. This finding also supports the agency theory which suggests that dividend payment will be declining where the incentives of the managers are excessive and do not commensurate with the performance of the firm. Other corporate governance mechanisms observed (debt financing, block ownership & directors' ownership) were found to be insignificant in explaining dividend payments.

Among the control variables, only lagged dividend and size were found to be significant. The coefficient of the lagged dependent variable (DIV_{t-1}) is statistically significant at 1% significance level and this justifies the inclusion of dynamism into the model. More so, it further implies that exclusion of the lagged dependent variable in the model would lead to problem of omitted dynamics. The significance of lagged dividend is consistent with Lintner's (1956) argument that previous dividend determines present or future payment of dividend. Size was also found to significantly affect dividend payment. Thus larger banks pay higher dividends suggesting that smaller banks possibly plough back profit for expansion. The model diagnostics satisfy the conditions to confirm that the findings from the model can be relied on. The Wald χ^2 is statistically significant at 1% significance level and this indicates that the model is statistically significant. The

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null hypothesis of first order autocorrelation is rejected at 10% significance level while second order autocorrelation is accepted. The Hansen test accepts the null hypothesis of overidentifying restrictions, thus indicating that the instrumental variables are valid and not correlated with the error term. The model does not suffer from the use of too many instruments because the number of instruments does not exceed number of groups.

5. CONCLUSION AND RECOMMENDATION

This paper examined the effect corporate governance mechanisms have on the dividend policy decisions of quoted deposit money banks in Nigeria between 2006 and 2016 using Two-Step System GMM estimator. In line with the findings, the study concludes that executive compensation affects firm's ability to reward shareholders in form of dividend payment. The study concludes further that the other components of corporate governance studied cannot affect the payment of dividend. Conclusively, executive compensation, lagged dividend and size are significant determinants of dividend payment among deposit money banks in Nigeria.

Based on these findings, this study recommends that regulatory bodies like CBN, NDIC should ensure that the compensation paid to the bank executives is regularised as this will promote uniform compensation in the banks and the interest of investors will not further be marginalised. Besides this, the compensation of the bank executives should be performance based, this will improve their performance and promote higher dividend payment to investors. The study also recommends that firms or regulatory bodies should help investors to be informed that while the larger firms can pay more, the growth firms need to plough back into the business for expansion. This in the long run is for the benefit of the shareholders.

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