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Effect of Dividend Policy on Market Price of Ordinary Shares of Quoted Manufacturing Firms in Nigeria

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Abstract
Understanding the micro-issue of relationship between financial policy variables and market price is crucial towards appreciating value-generating dynamics among economic sectors. This study investigates the effect of dividend policy on market price of ordinary shares of quoted manufacturing companies in Nigeria. The research focused on three specific policy variables namely: dividend payout ratio, dividend yield, and retained earnings. Ex-post facto research design and panel regression analysis were utilized to explore the relationships. Consistent with traditional right views, the study found significant relationship between the dividend variables and market price, indicating that higher payouts positively influence share prices. However, the analysis did not find evidence that retained earnings have a significant effect on share prices. This is a surprising result. The study recommends that manufacturing companies consider active use of dividend policy variables in maximizing shareholders wealth. Equally, companies should reassess the strategy of using retained earnings to finance operations.

Keywords: *Dividend pay-out ratio, Dividend yield, Manufacturing Sector, Panel data regression, Retained earning*

1. Introduction

Dividend policy and share price are crucial in corporate finance, especially in understanding how a company's decisions on payments to shareholders impact its stock market performance, and by extension, developments in the economy. For manufacturing companies, share price is an indicator of market confidence, operational efficiency, profitability, and future expansion potential.

Dividend policies can significantly affect the share price volatility of listed companies. The theoretical relationship between dividend policy and share price has been largely contextual, and had accordingly yielded contradicting results in empirical investigations. Some studies show a positive link between share price and higher dividend payouts (Akanni and Sweneme, 2016; Singh and Tandon, 2019; Terungwa and Benedicta, 2021), while others argue that dividend policy has little or no influence on share price (Nguyen et. al, 2021; Moseri, Owualah & Ogbebor, 2024).

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And yet, others see retained earnings, working through growth as key factor through which dividend policy could influence share values (Oscar, 1953, Dahmash et. al, 2023).

If trust and confidence of investors are not sustained with the kind of dividend policy formulated by company management, this will be critical for future financing decisions. This is because most investors, are said to heavily rely on dividends in modeling expectations of company and market performance (Cuong et. al, 2021). Yet, the exact nature of this relationship has eluded literature in a manner that continues to question relevance of dividend policy decisions in practice. The study fills the empirical literature gap by analyzing the relationship between dividend policy proxies and share price in the manufacturing sector of Nigeria providing insights that can assist corporate management in creating more successful dividend policies and enabling investors to make more informed decisions. Specifically, the study aims to address the ambiguity surrounding the relationship between the dividend policy-related proxies, namely dividend payout rate, dividend yield and retained earnings, and share prices of Nigerian manufacturing firms.

More than others, perhaps, manufacturing firms' desire stability in operations and profit performance and indeed divided policy for sustained operations (Adelegan, Adeyemo & Adejuwon, Adewale, 2021). The dynamic, and often times volatile, economic climate within which they operate influence profitability, making it crucial for financial managers to seek to optimize cashflow distribution policy in a manner that is non-disruptive of operations and equally value-maximizing.

Dividend yield is known to have a definite mathematical relationship with stock price, but it is often considered a fundamental indicator of a stock's appeal, hence its effect on share price is still debated. Variations in raw material prices, shifting customer demand, and different government policies, among other factors, affect a firm's disposition to pay a given amount as dividend, thereby complicating the process of figuring out the function of dividend yield in the price generating dynamics. This study aims to close this gap by carefully evaluating how dividend yields affect share prices in the Nigerian manufacturing sector, providing investors with better knowledge of how dividend yields might act as a stock performance indicator.

Retained earnings are part of net profits a business reinvests or spends for operations instead of paying dividends, which can improve a company's long-term profitability and market value. It enters the return generating process through the growth factor, and hence the discount rate for future dividend payments. So, it is argued that whether retained earning influences market price in one direction or the other is a function of growth generated by amount re-invested in the business. However, there is a dearth of studies specifically addressing how retained earnings affect share prices. By analyzing the relationship between dividend policy and share price, this paper aims to provide empirical evidence supporting the possible long-term advantages of investing in companies with high retained earnings and providing corporate management with understanding of how best to use retained earnings to increase shareholder value and stimulate market success.

In order to empirically determine the parameters of these relationships, the study proposes to test the following three hypotheses stated in null form:

H_{01}: There is no significant relationship between the dividend payout ratio and the share price of selected manufacturing companies.

H_{02}: Dividend yield has no significant impact on the share price of selected manufacturing companies.

H_{03}: Retained earnings have no significant effect on the share price of selected manufacturing companies.

2. Literature Review

2.1 Theoretical Review

The study is based on the Bird-in-Hand, Dividend Signalling and Dividend Irrelevance theories.

2.1.1 Bird-in-Hand Theory

The Bird-in-Hand Theory (Gordon and Lintner, 1956; Bello and Olarinde, 2020), suggests that investors prefer dividends due to their lower risk than potential future financial gains. The theory infers that a dollar invested today is better than a dollar invested tomorrow due to the risks and uncertainties associated with future earnings. Critics argue that the theory ignores retained earnings, which can be used for reinvestment and expansion, and that large dividend payouts may restrict a company's capacity to sponsor effective projects, affecting long-term growth. Research on dividend policies in Nigerian industrial companies can help understand investor behavior and market dynamics in developing countries.

2.1.2 Dividend Signaling Theory

Dividend Signaling Theory, developed by economists Merton Miller and Kevin Rock, suggests that dividend adjustments indicate a company's future performance to investors (Miller and Rock, 1985). It posits that higher dividend payments indicate management's confidence in future cash flows and profitability, reducing information asymmetry. This theory is relevant to research on dividends' impact on ordinary shares in Nigerian manufacturing enterprises, where economic instability and unpredictability can affect share prices. Nigerian empirical data supports the theory's applicability, with dividend announcements affecting share price volatility and greater share prices in Nigerian industrial companies positively connected to continuous dividend payments. The theory emphasizes the importance of dividends as a management communication tool and the benefits of consistent and predictable payout policies. This study can provide new insights into the signaling implications of dividend payments in emerging markets, emphasizing the importance of dividends as a management communication tool.

2.1.3 Dividend Irrelevance Theory

The Dividend Irrelevance Theory, first proposed by Franco Modigliani and Merton Miller in 1961, suggests that a company's dividend policy doesn't affect its stock price or cost of capital (Miller and Modigliani, 1961). The theory is based on presumptions such as symmetric information, no taxes, transaction fees, and agency costs. In a perfect market, a company's valuation isn't influenced by dividend payments or financing strategies. However, opponents argue that real-world flaws like taxes, transaction costs, and asymmetric knowledge can affect the applicability of dividend policies. The theory is useful for assessing dividends' influence on Nigerian manufacturing companies' share prices, but research has yielded contradicting results, suggesting that investor preferences and signaling effects may influence stock prices.

2.2 Conceptual Review

The dividend payout ratio is a key financial indicator that shows the percentage of firm earnings allocated to its owners as dividends. It helps investors assess if a company can continue paying dividends and attract more investors. A high payout ratio may appeal to income-oriented investors, while a low ratio may indicate a better deal for growth-minded shareholders. A high payout ratio can also indicate a company's inability to maintain enough earnings for future expansion, which could negatively affect its long-term share price. The dividend payout ratio is an important signaling metric that influences investor perspective and action. A consistent and predictable dividend payout percentage can increase investor confidence and minimize stock price volatility, especially in an emerging country like Nigeria. Understanding these factors is crucial for making smart decisions and plans.

Dividend yield is another key metric in finance, representing the annual dividend income per share derived from an investment as a percentage of current share price. It helps investors understand their expected income from their investments relative to the share market price. Higher income relative to the share price indicates higher attractiveness to income-oriented investors. However, an extremely high dividend yield could indicate potential financial crisis or declining share price issues for the corporation. Share price and dividend yield have a complex relationship, with unsustainable yields leading to more volatility. Understanding and assessing dividend yield can provide Nigerian manufacturing companies with fresh ideas on their financial status and stability, helping them develop reasonable dividend policies that enhance shareholder value and market confidence.

Retained earnings refer to the profits of a company that are re-invested in the organization instead of being shared with the owners as dividend payments. These earnings are used to repay debt, finance research and development, or facilitate expansion. They are an essential part of shareholder equity and contribute to the company's financial position and potential for growth. Retained earnings are crucial for strategic purposes such as financing new projects, acquiring additional assets, or reducing debt, which enhance the value of the company. Retained earnings signal a company's prioritization of long-term growth and sustainability to investors, while stockholders may experience reduced immediate returns. Maintaining a well-balanced dividend policy is essential to meet both shareholder expectations and the company's reinvestment needs.

Share price is a crucial aspect of a company's financial strategy, as it shows the value of its shares in the market. Share price is influenced by various factors, including investor attitude, company-specific news, and economic situation. Share prices are also influenced by market factors like geopolitical events and economic data, as well as internal elements such as management activities, strategic goals, and company governance practices. Understanding the elements influencing share prices is essential for investors and corporate management to navigate the stock market and achieve financial stability and growth. Maintaining a consistent and rising share price is essential for business management to draw support for long-term strategic goals.

2.3 Empirical Review

Koleosho, Akintoye, and Ajibade (2022) found a correlation between dividend policy and share price volatility (SPV) in Nigerian NGX-listed businesses. The dividend payout ratio (DPR) was found to be the most significant factor in SPV, with a p-value less than 0.05. However, factors like dividend yield, dividend per share (DPS), and financial leverage had minimal effects on SPV.

James and Iwedi (2020) examined dividend policy's impact on return on investment (ROI) in Nigerian industrial companies between 1985 and 2014. They found favorable correlations between dividend payout ratio, retention ratio, and dividend yield and return on investment, but no statistically significant relationship with ROI.

Moseri, Owualah, and Ogbebor (2024) examined earnings per share, dividends per share, dividend yield, and firm size in Nigerian manufacturing companies from 2013 to 2022. The study found a one-way causal link between lagged share prices (LSP) and dividends per share (DPS), with no significant effect on share price behavior. The study suggests that Nigerian manufacturing enterprises should focus on increasing transparency in their profit reporting to boost investor confidence and reinforce the correlation between profits per share (EPS) and share prices.

Akani and Sweneme, (2016) conducted a study on the impact of dividend policy on the profitability of Nigerian manufacturing companies from 1981 to 2014. The study used Walter's Model Analysis, the Bird-in-the-Hand Theory, and the Miller-Modigliani Hypothesis to analyze the relationship between dividend policy, corporate performance, and value. The results showed a positive correlation between dividend payout ratio, retention ratio, dividend yield, earnings per share, and Return on Investment (ROI) and Net Profit Margin.

Korea, Njoku and Lee (2024) examined the relationship between dividend policy, corporate performance, and value in the Korean market. They found a positive correlation between cash dividend payments and Tobin's Q and market-to-book ratios. However, the study made differing conclusions on performance criteria between Chaebol and non-Chaebol businesses.

Nguyen, Pham, Doan, Ta, Nguyen, and Truong (2021), investigated the impact of dividend policy on financial performance of Vietnamese firms using Miller and Modigliani's 1961 dividend irrelevance theory. The study found that the choice to distribute dividends had a detrimental effect on accounting-based performance indicators, even if raising market expectations.

Singh and Tandon (2019), investigated how dividend policy influenced the market pricing of 50 businesses on the National Stock Exchange (NSE). The random effect regression model showed the importance of dividend policy, implying that it greatly affects firm stock prices. Terungwa and Benedicta (2021), examined the dividend policy's impact on the valuation of Nigerian consumer products businesses. They found a favorable relationship between dividend per share and market price per share.

3 Research Methodology

This research study focuses on the effect of dividend policy on the price of common shares of Nigerian manufacturing enterprises. The research design adopted is ex-post facto research, utilizing secondary data from stock exchange records and financial filings.

The study population includes 23 consumer products manufacturing businesses listed on the Nigerian Stock Exchange (NGX) from 2015 to 2023. Purposive sampling technique was used to ensure the most relevant and complete data are selected. Moreover, the stocks are actively traded in the market, hence their prices are more likely to reflect desired sensitivity to typical corporate actions like dividends. The sample consists of five firms including Cadbury Nigeria Plc, Dangote Flour Mill Plc, Guinness Nigeria Plc, Honeywell Flour Mill Plc, and Nigerian Brewery Plc, all of which reflect Nigeria's manufacturing sector and have a history of maintaining stability in dividend policies.

Data was collected and validated using secondary sources, including annual financial statements of the selected companies. Cross-referencing financial statements with other credible sources ensures the validity of the data and increases the credibility of the research results.

The study used both descriptive and inferential analysis to analyze the relationship between dividend payout ratio, dividend yield, retained earnings, and share price of selected manufacturing companies in Nigeria. A single panel regression model is used to evaluate the relationship between dependent and independent variables. This methodical technique allows for a comprehensive review of the data, providing both strong descriptive summaries and reliable inferential conclusions. The model of this study is specified thus,

$$SP_{it} = \beta_0 + \beta_1 DPR_{it} + \beta_2 DY_{it} + \beta_3 RE_{it} + \varepsilon_{it} \quad (1)$$

Where:

SP_{it} = Share Price of firm i at time t

DPR_{it} = Dividend Payout Ratio of firm i at time t

DY_{it} = Dividend Yield of firm i at time t

RE_{it} = Retained Earnings of firm iii at time t

β_0 = Intercept

$\beta_1, \beta_2, \beta_3$ = Coefficients of the independent variables

ϵ_{it} = Error term

The expected relationships between the dependent and independent variables are based on theoretical and empirical literature. These expectations are outlined in the Table 1 below:

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Table 1: Apriori Expectations

Independent Variable	Expected Sign	Reason	Source
Dividend Payout Ratio (DPR)	+	Higher dividend payouts are often perceived as a signal of financial health, potentially increasing share prices.	Akani & Sweneme (2016); Njoku & Lee (2024)
Dividend Yield (DY)	+	Higher dividend yields indicate higher returns on investment, which can attract investors and raise share prices.	Singh & Tandon (2019); Moseri et al. (2024)
Retained Earnings (RE)	+	Retained earnings are reinvested in the company, potentially leading to growth and higher future profits, thus increasing share prices.	James & Iwedi (2020); Nguyen et al. (2021)

4 Results and Discussions

The data for the period 2015-2023 is analyzed as presented below. The study examines the impact of dividends on ordinary share prices, providing insights into financial performance and investor returns in the Nigerian manufacturing sector.

4.1 Descriptive Statistics

Table 2: Descriptive Statistics for Data on Share Price (SP), Dividend Payout Ratio (DPR), Dividend Yield (DY), and Retained Earnings (RE) for Sampled Manufacturing Firms

	SP (₦)	DPR	DY	RE (₦'m)
Mean	26.76	0.46	0.03	30.6
Median	12.50	0.45	0.03	15.4
Maximum	148.00	0.70	0.05	103.0
Minimum	8.00	0.25	0.01	2.9
Std. Dev.	34.39	0.11	0.01	29.8
Skewness	2.56	0.27	0.05	1.21
Kurtosis	8.51	2.22	2.39	3.18
Jarque-Bera	105.85	1.70	0.72	11.06
Probability	0.00	0.43	0.70	0.00

Table 2 presents descriptive statistics of share price, dividend payout ratio, dividend yield, and retained earnings of the sampled manufacturing firms. The mean share price is ₦26.76, with standard deviation of ₦34.39 indicating significant variability in stock prices. The average dividend payout ratio is 0.46, with moderate variability. The mean dividend yield is 0.03, with low variability and a nearly symmetric distribution. The mean retained earnings is ₦30.6m, with high dispersion. The Jarque-Bera statistics for SP and RE indicate deviations from normality, while DPR and DY are closer to normal distributions.

4.2 Diagnostics Tests

Table 3: Correlation Matrix showing the association between Share Price (SP), Dividend Payout Ratio (DPR), Dividend Yield (DY), and Retained Earnings (RE) for Sampled Manufacturing Firms

	SP	DPR	DY	RE
SP	1.00	0.45	0.38	0.49
DPR	0.45	1.00	0.98	0.49
DY	0.38	0.98	1.00	0.45
RE	0.49	0.49	0.45	1.00

Table 3 shows a correlation matrix illustrating the relationships among Dividend Payout Ratio (DPR), Dividend Yield (DY), Retained Earnings (RE) and Share Price (SP) for the manufacturing firms. The correlations show a moderate positive relationship between SP and DPR, a weaker positive relationship between SP and DY, and a moderate positive relationship between SP and Retained Earnings (RE). These correlations highlight the interconnectedness of financial metrics and their collective impact on share prices.

The Hausman Test is crucial for determining the model between fixed and random effects in panel data analysis. It helps identify correlations between regressors and error terms, ensuring accurate estimation and inference without bias from unobserved heterogeneity in the study of the dividend proxies.

The Hausman test results in Table 4 show a significant Chi-Square statistic, suggesting that the random effects model is not suitable for the data. Instead, the fixed effects model should be used, accounting for unobserved heterogeneity and providing more accurate estimates for dividend policy impact on share prices.

Table 4: Hausman Test

Correlated Random Effects - Hausman Test Test cross-section and period random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	0.000000	3	1.0000
Period random	0.000000	3	1.0000
Cross-section and period random	15.232261	3	0.0016

4.3 Regression Results

Table 5: Regression (Fixed Effects) Model Results

Dependent Variable: SP
Panel Least Squares

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	7.826203	2.255183	3.470317	0.0013
DPR	3.037459	1.353662	2.243882	0.0309
DY	1.959111	0.860831	2.275837	0.0287
RE	-0.023466	0.057179	-0.410394	0.6839

R-squared	0.911623	Mean dependent var	2.868742
Adjusted R-squared	0.894903	S.D. dependent var	0.782720
S.E. of regression	0.253747	Sum squared resid	2.382345
F-statistic	54.52298	Durbin-Watson stat	1.757193
Prob(F-statistic)	0.000000		

The study examines dividends' impact on manufacturing companies' share prices using panel least squares. Having accounted for cross section and period effects, the regression results (Table 5) show that dividend payout ratio (DPR) positively affects share prices, the same with dividend yield (DY). Retained earnings (RE) has an insignificant negative effect. The model has high explanatory power, explaining 89% of share price variability.

The study found a significant positive relationship between the dividend payout ratio (DPR) and share price of Nigerian manufacturing companies. A 1% increase in DPR resulted in approximately 3.04% increase in share price.

Similarly, the study found that dividend yield significantly impacts the share price of Nigerian manufacturing companies in a positive way. A 1% increase in dividend yield leads to a 1.96%

increase in the share price, a somewhat less responsiveness as a consequence of moderation by market factors.

The regression model reveals that retained earnings (RE) has no significant effect on the share price of the manufacturing companies. A 1% increase in RE is associated with approximately 0.02% decrease in share price. However, the standard error shows high p-value which suggests that this result is statistically insignificant.

4.4 Discussion of Findings

The study reveals a significant relationship between the share price of the selected manufacturing companies and the dividend payout ratio, indicating investor preference for dividend-paying stocks. In other words, the market is prepared to pay higher premium for stocks that pay higher dividend to shareholders. The study also found that the share price is positively influenced by dividend yield, indicating that investor's place a high value on income generated from dividends in the capital market, and naturally will have high confidence in equity instruments issued by the manufacturing firms with robust dividend policies. Singh and Tandon (2019) reached similar conclusion. However, Koleosho, Akintoye, and Ajibade (2022) suggested that the relationship between dividends and share prices may be complex and context-dependent. The study also found no significant evidence that retained earnings have an impact on share prices, contradicting previous research that found retained earnings to have a significant impact on share prices. Could this be as a result of clientele effect? Perhaps, further research is needed to understand the specific situations under which retained earnings could affect share prices.

5 Conclusions and Recommendations

5.1 Conclusion

This study highlights the significant impact of dividend policies on manufacturing companies' share prices. It reveals a significant relationship between dividend payout ratios and share prices, indicating investors' preference for dividend-paying stocks. Higher dividend yields also contribute to higher share prices, indicating that investors are readily able to pay premium for such stocks in the capital market. However, the study found no significant impact of retained earnings on share prices, suggesting investors may prioritize immediate dividend returns over future gains.

Therefore, companies should consider strategies to enhance dividend payout ratios and yields to attract and retain investors, thereby enhancing market valuation and financial performance.

5.2 Recommendations

The study recommends that manufacturing companies adopt generous dividend payout ratios to maximize wealth of shareholders. More so, maintaining and potentially increasing dividend yields is crucial for maintaining investor confidence, and ensuring attractiveness equity instrument as viable option for raising capital from the financial market.

Balancing retained earnings and dividend distribution is essential for maximizing shareholder value, as retained earnings have a minimal impact on share prices. Firms should ensure that amounts retained in the firm are invested in positive net present value projects to grow cash flows and enhance share prices.

5.3 Limitations of the Study

The study of impact of dividends on prices of ordinary shares of Nigerian manufacturing companies faced limitations due to market volatility, and inherent biases in data collection and reporting. The decision to exclude un-quoted firms and the less active stocks in favour of the more stable ones led to further limitation in scope of the research.

5.3 Suggestion for Further Studies

Future research on dividends' impact on Nigerian manufacturing companies' share prices could explore periods associated with different policy regimes, periods of economic downturns and recoveries, periods of industry-specific trends, and corporate governance's influences. Private firms could equally be studied to understand the link between dividend characteristics and their intrinsic values.

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